S. HRG. 109–1124

REVIEWING THE DEPARTMENT OF TRANSPORTATION'S NOTICE OF PROPOSED RULEMAKING THAT CLARIFIES THE RULES REGARDING FOREIGN INVESTMENT IN U.S. AIR CARRIERS

HEARING

BEFORE THE

SUBCOMMITTEE ON AVIATION

OF THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION
UNITED STATES SENATE

ONE HUNDRED NINTH CONGRESS

SECOND SESSION

MAY 9, 2006

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ONE HUNDRED NINTH CONGRESS

SECOND SESSION

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TUESDAY, MAY 9, 2006

U.S. SENATE,
SUBCOMMITTEE ON AVIATION,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
Washington, DC.

The Subcommittee met, pursuant to notice, at 2:30 p.m. in room SD–562, Dirksen Senate Office Building, Hon. Conrad Burns, Chairman of the Subcommittee, presiding.

OPENING STATEMENT OF HON. CONRAD BURNS, U.S. SENATOR FROM MONTANA

Senator BURNS. We'll call the Committee to order. And we've got a lot of ground to cover today. And I want to thank my friend from North Dakota for being here. And there'll be other members. They wrote—they said they'd be here, but, you know, they're not always the most reliable attenders at times. So, we will get started.

I want to thank everyone for coming today. Before we start, I want to say we still send our "Get Well" greetings to the Ranking Member of this committee, Senator Rockefeller. He has had surgery, and he's still convalescing, I think, is the correct word. And he's still recuperating, and we wish him a speedy return, because I'm—we're going to need some help on some issues, coming up.

Today, we review the recently issued Department of Transportation supplemental notice of proposed rulemaking that seems to clarify the rules regarding foreign investment in U.S. air carriers.

Since 1926, Federal law has required U.S. air carriers, including cargo carriers, to be owned or controlled by citizens of the United States. The Department of Transportation is tasked with enforcing those statutes. One criteria of that enforcement is a citizenship review of who is in actual control of the airline. The interpretation and impacts of actual control of an airline will be examined today.

Currently, both the House and Senate versions of the supplemental appropriations bill contain, in one form or another, provisions blocking this rulemaking. Conference meetings will soon commence on that bill, and I am hopeful that this hearing will assist us in making a principled decision on how to ultimately address this issue. Like many of my colleagues, I'm concerned about the possible impact such change would have on the CRAF program,

along with the overall safety and security, is the application of such a rule plausible in a real corporate structure, and is it the right thing to do for aviation industry as a whole? Additionally, will further liberalization and foreign investment opportunities for airlines equate to better service and opportunity for my constituents? Route structure and availability are certainly on my mind. And I would like to be confident that rural markets would not be harmed by these new policies. I think everyone is also aware of the possible comprehensive Open Skies Aviation Agreement with Europe hangs in the balance. Our decision to move forward will certainly affect that negotiation's outcome.

And I want to thank everyone for coming today. And now I recognize Senator Dorgan, from North Dakota.

STATEMENT OF HON. BYRON L. DORGAN, U.S. SENATOR FROM NORTH DAKOTA

Senator DORGAN. Mr. Chairman, thank you very much.

You're all familiar, of course, with hula-hoops and frisbees and slip-n-slides. They are all products produced by Whammo Corporation, which has just been purchased by the Chinese. No one heard a whisper from me about that purchase. I could care less whether there's foreign ownership of frisbees. But foreign ownership and control of U.S. airlines is of concern to me. And it's interesting to me that there is a rulemaking now on Federal law in which an agency is parsing words to try to understand, What do the two words, "actual control," really mean? Only in Washington would we not understand what "actual control" really means. And my sense is that we are rushing, at 100 miles an hour, of course, toward a whole range of international interests and interconnections. It is a global economy, a global world, largely without the rules having kept pace. With respect to this issue, this single issue in which we legislated long ago, and have long-established Federal law, that is the foreign ownership and/or control of airlines, I'd like us to slow down just a bit, think a bit, and come to a conclusion that makes sense for this country, for our economic security interests, and for our national security interests.

I was troubled, when I read the briefing for this hearing, to understand how much we must pay some of the most well educated, bright people that are available to be hired who cannot understand the two words, "actual control," it's something perhaps we can visit about the rest of the afternoon.

Mr. Chairman, thank you very much.

Senator BURNS. We've always had problems with definitions.

Now, the former Chairman of the Full Committee, Senator McCain.

STATEMENT OF HON. JOHN McCAIN, U.S. SENATOR FROM ARIZONA

Senator McCAIN. Thank you very much, Mr. Chairman. Thank you for holding this hearing.

As you mentioned, in 1926 Congress enacted the Air Commerce Act, which restricted foreign ownership of any U.S. airline to 49 percent. The government's goal at that time was, in part, to protect a fledgling industry. Twelve years later, protectionist leanings pre-

vailed again, and foreign investors were limited to owning 25 percent of the voting stock of domestic air carriers. Forty years after that, the airline industry was generally deregulated. But 80 years after Calvin Coolidge signed the Air Commerce Act into law, and nearly 30 years after deregulation, we have yet to eliminate several regulatory restrictions on the airline industry, including the Perimeter Rule, the Wright Amendment, and the topic of today's hearing, legislation that severely restricts foreign ownership of domestic airlines.

The President, in 2003, proposed loosening the ownership restrictions to lower the foreign ownership threshold back to 49 percent. Congressional opposition scuttled that effort.

A review of the Department of Transportation's proposed rule show that it's a modest proposal, at best. Nevertheless, the emergency supplemental for Iraq and Katrina—Iraq and Katrina—that's now in conference, contains a provision that would delay the rulemaking until the end of this fiscal year. What relation that has to do with Katrina and Iraq escapes me.

Over the past 4 years, we've seen some of our Nation's largest airlines falter into bankruptcy—US Airways, United, Northwest, Delta. At one point last year, four of the Nation's seven largest airlines were in bankruptcy. And to recover from these bankruptcies and to sustain their operations, our Nation's airlines need sources of funding and a broader ability to enter into cooperative agreements with foreign carriers.

This is not a theoretical problem. According to a 2003 GAO report, foreign airlines have attempted to invest in, and influence the operations of, U.S. airlines several times. The report notes that foreign airlines have, on occasion, invested significant amounts of capital into U.S. airlines, only to later dis-invest, due, in part, to U.S. policies concerning airline control. Rather than limiting the sources of funding for our Nation's airlines, we should be making sure they have all the capital they need to manage and expand their operations domestically and abroad.

So, Mr. Chairman, we're back to the old protectionist issue again. And since we've made so little progress in the past, we will probably continue these protectionist policies, to the detriment of American economy, to the detriment of the American airlines, and certainly to the detriment of the airline passenger. I hope that someday we will wake up and recognize that we live in a global economy, and one in which foreign investment in our airlines can be very helpful, rather than harmful. And I would say that this issue, we have visited and revisited on numerous occasions. But I thank the Chairman for holding this hearing.

Senator BURNS. Senator Lautenberg?

STATEMENT OF HON. FRANK R. LAUTENBERG, U.S. SENATOR FROM NEW JERSEY

Senator LAUTENBERG. Thanks, Mr. Chairman. I appreciate your holding this hearing.

The question of foreign control of U.S. airlines, a critical issue, has implications for the safety of the air passengers, as well as our national security. Three years ago, Congress updated aviation law to specify that U.S. citizens must have "actual control"—and we

could have a debate about those couple of words, over our domestic airlines.

The law is pretty clear. "Actual control," means exactly what it says. However, this proposal, from the Bush Administration, performs all kinds of legal acrobatics to circumvent Congress and the law.

Now, I was formerly a CEO, and I witnessed, personally, how tough it is to keep everybody working toward the same goal within an organization when their particular departmental or private interests differ. And it separates loyalties at times. But that is what the Administration is proposing to do with the ownership of domestic airlines.

We have a chart. As a matter of fact, it's a pretty interesting art form, I thought, but it does show the confusion that exists by virtue of the fact that shareholders now have their particular—their particular opportunities—can you see it? Because I can't. But——

[Laughter.]

Senator LAUTENBERG.—the red indicates—those areas, the red circles—indicate those areas that would still be left to American control. And that's kind of interesting, to see how that might serve as a flow chart for a morning meeting. The only thing clear about this chart is that the Administration's proposal would be a recipe for confusion.

Now, domestic airlines obviously play a significant role in our national defense. And in times of war or national emergency, the Department of Defense might need the airlines to transport materials, or even personnel.

Now, there is a section called "CRAF," which is designed to be reserved for decisionmaking by the American Government when there is conflict at our doorstep, but the chart doesn't look like a way to maximize the safety of our airlines or the security of our Nation. It looks more like something we might see from the senior management of a company like Enron. Now, can you imagine, if we have a difference of mission with the French, they could start calling them "Freedom fries" again. It would be terrible.

But how do we entrust that function of our society? And as Senator McCain pointed out, the fact is, we went full bore to try and provide the liquidity that our airlines needed to work, over $20 billion since 9/11. Do we just say that, "Well, OK, that was an investment to keep our guys going?" But what happens when that company is owned and controlled by another foreign national or a foreign government and they run into financial problems? Do we then say, "OK, well, you're not going to be operating between Chicago and New York, and L.A. and Chicago. We're not going to keep you going. You're a foreign entity?" Those kind of decisions tell me that this is not a particularly good idea and certainly deserves far more debate than we're going to have here this morning.

So, we're going to consider opening the door to more foreign control of and investment in our airlines. We ought to go about it the right way, and changes to the law ought to be aired before this committee. I had the opportunity over the years to join with Congressman Oberstar in some very significant aviation matters; in particular, the downing of Pan Am 103 and how essential it was that we had the full cooperation of a friendly nation. But if we

didn't have, we'd never have been able to understand what took place in those days. And so, we're back, Jim, on a similar track today. We've got to protect our opportunity to direct our airlines as we think they should function.

Thank you very much, Mr. Chairman.

Senator BURNS. Thank you, Senator.

Senator Stevens, as Chairman of the Full Committee, do you have a statement?

The CHAIRMAN. No.

Senator BURNS. We are joined today by two distinguished Members of the House of Representatives, and we'd like to hear from them now. We have the Honorable John Mica, representing the 7th District of Florida.

Representative Mica, thanks for joining us today.

STATEMENT OF HON. JOHN MICA, U.S. REPRESENTATIVE FROM FLORIDA

Representative MICA. Thank you, Chairman Burns and distinguished members of the panel. Pleased to be with you and have this opportunity to——

Senator BURNS. You just have to pull it up a little bit closer to you.

Representative MICA. Is that it? OK. Don't want to miss a word here. I'm pleased to be with you.

Senator BURNS. Hanging on every one of them.

Representative MICA. Thank you. I know you will.

[Laughter.]

Representative MICA. Again, I'm pleased to present testimony on this important issue of foreign investment on the pending historic United States-European Union agreement.

Today's hearing on the DOT rule in the supplemental offering that's been provided, and the United States-EU agreement, could present Congress with a very clear, but stark, choice. And that is, will the United States continue to lead, or will we abdicate a leadership role by succumbing to unfounded fears relating to this matter?

I, for one, believe the United States should continue to lead. The U.S.-EU Open Skies Agreement creates the largest and the most important air service market in the entire world. It has the potential to be a watershed event in commercial aviation, and is long overdue.

The benefits to, first of all, airlines, to consumers to shippers and to economies on both sides of the Atlantic, all of these benefits, really, if we look at them, are unquestioned. Potential benefits also will be seen by the U.S. airframe, aircraft engine, and avionic manufacturers. And they hold the potential for being tremendous advantages. Today, we have some 70 Open Skies Agreements with air service trading partners, large and small, and also some of those with mature and also expanding economies.

Mr. Chairman, by every measure, Open Skies has been a success for all of us. It's expanded competitive choices for consumers, passengers, and shippers alike. By building efficient air service trade bridges and expanding them between the U.S. in virtually every corner of the world, it's created superhighways in the sky for global

trade and commercial activity. Building on this success last fall, the U.S. and some 25 Member States of the EU reached a text agreement to fully open the transatlantic services and markets on a multilateral basis. That provisional agreement presents a very historic opportunity for the United States to leap beyond a patchwork of Open Skies and restrictive bilateral agreements with some of these European countries. And, in their place, I think we can substitute a wide-ranging multilateral Open Skies pact, and that's what's in the offering.

Significantly, one of the newly opened markets will be the United Kingdom, whose—unfortunately, their restrictive aviation policy has harmed consumers on both sides of the Atlantic for nearly three decades. Given decades of Heathrow-access-related frustration, this development, I believe, will be especially welcome. There's an active market for Heathrow slots, as the recent experience of carriers such as Qantas, the United Emirates, and Jet Airways shows. Carriers that rely on this secondary market can quickly build meaningful slot positions at Heathrow. This market option isn't without cost, and it requires hard work. But, quite clearly, there is a market-based alternative to sitting still and fighting much needed change.

Last November, DOT announced a proposal to expand opportunities for cross-border investments in airlines by allowing foreign investors to participate more actively in the day-to-day commercial decisions of U.S. airlines, and I believe they did that without running afoul of the statutory requirements that U.S. citizens have—and we've heard the term—"actual control" of these airlines.

Mr. Chairman, let me be absolutely clear. If DOT's rule did not adequately protect the safety, security, and national defense and Civil Reserve Air Fleet requirements, I'd be the first Member of Congress in line to oppose any change. As much as I support the U.S.-EU Agreement, I'd never risk safety and security or national defense to attain it.

I was pleased that DOT has recently issued a supplemental offering to its original proposal that elaborates further on safeguards to fully protect safety, security, and national defense issues. And I think you'll hear a little bit more from the Administration on the specifics of that.

Finally, let me say, DOT's proposed rule is not mandatory. To the contrary, it's discretionary. In fact, it offers U.S. carriers an additional option to secure capital in the U.S. market on commercially-reasonable rates, and that's just like every other—just about every other industry you can name in America.

So, again, I think that we also endanger, by not moving forward, the serious loss of credibility in our efforts to continue—continuing open and critical air service in some of the Southeastern Asia markets, China, Hong Kong, Japan, and, of course, as I said, the United Kingdom. And, finally, you can look for billions and billions of dollars in economic benefits to consumers, economic opportunities, jobs, creation of new opportunities for some of our struggling carriers in our industry.

So, I think we're at a critical junction. I hope that we'll look very carefully at the provisions that FAA is—has crafted, and that we'll

leave here not with a lot of rhetoric, but maintaining the U.S. leadership in global aviation.

So, I look forward to hearing from my colleague in the House, and thank you for the opportunity to present my case.

Senator BURNS. Thank you. And now, our good friend and distinguished Member of Congress, Jim Oberstar. Thank you for coming today, and we look forward to your testimony.

STATEMENT OF HON. JAMES L. OBERSTAR, U.S. REPRESENTATIVE FROM MINNESOTA

Representative OBERSTAR. Thank you very much, Mr. Chairman—Burns—and Chairman Stevens, colleagues, several former colleagues in the House, now in our other—distinguished other body. I appreciate that you are holding this hearing. You recognize the significance, the importance of this NPRM and this negotiation with the European community has for the future of aviation.

And I listened with attention to what Senator McCain said about protectionism. In 1944, as the U.S. was—and our allies were drawing—could see the end coming in World War II, President Roosevelt convened an aviation conference in Chicago to map out the post-War shape of aviation, sent a telegram to Winston Churchill, in which he said, "Let not the dead hand of protectionism stifle the promise of a great market in aviation." Churchill's response was to say that—he'd come out of World War II, America, as the—unscathed, it has the biggest aviation fleet in the world, we'll all be at a disadvantage. And the British, on behalf of themselves and others, negotiated what we know today as bilateral regime in what we know as the Chicago conference.

In 1989—well, first, in 1978, I voted for deregulation, thought it would energize the aviation sector, and it did. Fares are, on average, $6 and a half billion a year less for travelers today than they were pre-deregulation, and to the benefit of air travelers. But in 1989, as Chair of the Aviation Subcommittee at a conference in Europe, I proposed to the European community, having done my graduate studies at the College of Europe, knowing all that it took to create the European economic community, that, "We throw out the bilaterals, negotiate a single Open Skies agreement. But, if you don't, then we, the United States, will negotiate with you, country by country, and we'll get the better of the deal."

They weren't ready then. They weren't ready in 1944. They weren't ready in 1989. Now maybe they are. But the U.S. negotiators have thrown in something that has little, if anything, to do with Open Skies exchange of commerce, rights for rights, and values for values, and that is the ownership issue.

Now, whether or not you agree with foreign investment in U.S. airlines, you should agree that that decision should be made by the legislative body and not by the Executive Branch, unless you want to duck the issue. For 65 years, aviation in the world's largest open air trade market, the United States, two-thirds of all air travelers last year traveled in our airspace. We account for more than half of all the aircraft in the world in commercial aviation. We account for more than half, maybe two-thirds, depending on how you calculate it, the world's value in aviation in the U.S. marketplace. Every other country wants to get into our market to deal here. But

under the bilaterals—if we had done steel trade in the same way that we do aviation trade, bilaterals, we wouldn't have lost the steel industry, we wouldn't have lost other industries, because we trade value for value and rights for rights. Done under an Open Skies, it's gone. That's fine. You can trade on what basis you want.

But the issue, for 65 years, has been, an airline qualifies as a citizen of the United States that provides service between cities in the United States or on international routes negotiated by the U.S. in our international trade agreements. "Citizen of the United States" is further defined as one—as an airline that is under the control—and I'll give you the exact words—"corporation or association which is under the actual control of U.S. citizens." You don't need a dictionary to understand what "actual control" means. Clearly, the Department of State or Department of Transportation does not have the authority on its own to limit the requirement of actual control as proposed in their notice of proposed rulemaking to a requirement of control only over safety, over security, and over the Civil Reserve Air Fleet.

Our courts have held that an Executive Branch agency has discretion to interpret a statute, but does not have the discretion to conflict with the plain meaning of the law.

Now, how can you have actual control if the rule limits that control to certain policies of an airline, but not others? Under the NPRM, they—a foreign investor, foreign carrier, can decide fleet size, fleet composition—that is, what type and model of aircraft they fly in their fleet—which markets to serve, which markets to pull out of. The decision is very clear.

Now, this make-up of control could decide that the foreign interest is going to change the fleet composition and take out the DC–10s and the 747s that are part of the Civil Reserve Air Fleet. Now, years ago I held hearings on that subject of the CRAF program, when we reauthorized it. In the current engagement in Iraq, CRAF was activated in February of 2003. Fifty-one passenger aircraft, 11 airlines, moved 11,000 tons of cargo and 254,000 troops. We have 1,293 aircraft in 39 U.S. airlines committed to the Civil Reserve Air Fleet. Foreign carrier can simply say, "I'm not going to have 747s. They're whales. They consume too much fuel. We're not going to have DC–10s in that fleet. They consume too much fuel." And during Gulf War I, those Civil Reserve Air Fleet aircraft flew troops and equipment into the Gulf and deadheaded back, while our competitors are flying revenue passengers out of the war zone into the United States. Now, is that the future that you want for aviation for the United States?

So, they ran up against a wall, against that issue, and have issued a clarification. This is it, 75 pages of clarification of what they mean by "actual control." And it's not in the rule. This is in the preamble to the rule.

So, now they go and say they're having—they're reinterpreting the standard and are going to say that the requirement in the law is that the President of a U.S. airline must be a citizen of the United States—all right, that's fine—must be independent of foreign control—that's right. The President of the airline would have to be divorced from all commercial decisions if a foreign owner controls that airline. It would be inconsistent with a U.S. person who

is President of the airline under foreign control to do other than what the foreign ownership wants it to do.

So, how does that President of the U.S. airline be a President only for safety, only for security, and only for the CRAF program, has nothing to say about all those yellow dots—I'm sorry, blue dots that Senator Lautenberg has on this chart. That's a very graphic description of what happens under the foreign ownership initiative in this document.

Senator BURNS. Can you wrap up——

Representative OBERSTAR. OK.

Senator BURNS.—pretty quick? I've got a pretty full panel, and I don't want to be subject to a filibuster here.

Representative OBERSTAR. Excuse my enthusiasm for the subject matter, Mr. Chairman——

Senator BURNS. No, you're very——

Representative OBERSTAR.—but you're not going to hear this stuff from some of these other witnesses, and I just want to be very clear that—you know, you're going to hear, "Oh, we've got such a good deal." We heard that before, in the Carter Administration, under Bermuda II negotiations, "Oh, we've got such a good deal. We can't let this go." And, as a result, we've been strangled in the British market, which is half of the U.S. North Atlantic trade.

This deal can sit on the table until the Congress has had an opportunity to decide what it wants to do, and not the Department of Transportation.

[The prepared statement of Mr. Oberstar follows:]

PREPARED STATEMENT OF HON. JAMES L. OBERSTAR, U.S. REPRESENTATIVE FROM MINNESOTA

Chairman Burns, Ranking Member Rockefeller, you are holding this hearing because you recognize that our government is engaged in one of the most important aviation policy decisions since deregulation was enacted in 1978: the DOT's proposal on foreign ownership.

The NPRM on foreign ownership in effect would trade away the crown jewel of American transportation—our Nation's airlines—at their most vulnerable moment, to their foreign competitors. This would be done to conclude an Open Skies agreement with the European Union, an Agreement which State and DOT describe as a major breakthrough, but which in reality, would provide only limited benefits for United States' airlines, given the difficulty of getting slots to implement the new rights that our carriers will get at Heathrow.

Our negotiations team will likely tell you, as they have said in other venues: "If we don't conclude this agreement now, this opportunity will be the last." Don't fall for that siren song—I've heard it before—at Bermuda, during the Carter Presidency. I heard it during the Reagan Administration, in negotiations on cargo rights with South Korea and Japan. I said, "Go back and do better; we can wait." The U.S. accounts for two-thirds of the world's aviation market. Foreign carriers are dying to get in—they can enter our market when we enter theirs, on terms that balance the benefits—value for value, rights for rights.

For the past 65 years, U.S. commercial aviation has been guided by a statute, which provides that only an airline that qualifies as "a citizen of the United States" may provide service between cities in the U.S., or on international routes obtained by the U.S. through international agreements. The law clearly says that an airline may qualify as a U.S. airline, only if the airline is "a corporation or association . . . which is under the '*actual control*' of U.S. citizens."

Under DOT's proposed new standard, foreign investors would be allowed to exercise control over all *commercial aspects* of U.S. airline operations, including fleet mix, routes, frequencies, classes of service, and pricing etc. U.S. citizens would be required to control only decisions affecting the Civil Reserve Air Fleet (CRAF), transportation security, safety and organizational documents.

It is clear to me that the Department does *not* have the legal authority to limit the requirement of "actual control," to a requirement of control over *only* safety, se-

curity and CRAF decisions (and not over other economic decisions). Our courts have held that although an Executive Branch agency has discretion to interpret a statute, an agency does not have discretion to make interpretations that conflict with the "plain meaning" of the law.

I do not see how it can be consistent with the plain meaning of "actual control" to limit that term to a requirement of control over some policies of an airline, but not control over many important decisions, such as the rates to be charged and the service to be operated.

Moreover, the proposed new interpretation of "actual control" is inconsistent with the requirement in the law that "the President" of a U.S. airline must be a citizen of the United States. DOT has correctly ruled that not only must the President be a U.S. citizen in the technical sense, but he must also be independent of foreign control. This means that if an airline decided to allow foreign interests to control commercial decisions, the President of the airline could not carry out the policies of the foreign investors, because he would then lose his status as a U.S. citizen. The President, then, would have to be divorced from all commercial decisions. Surely, when the law required that the President of an airline must be a U.S. citizen, it meant a President who ran the entire airline, not just safety, security and the CRAF program.

I would note that one of your witnesses today, Federal Express, stated in its initial comments in October 2003 on the foreign control issue that "while the issue of citizenship is the center of noisy debate among aviation law pundits, the Department presently has no legal authority, nor any mandate from Congress, to make changes to its implementation of the U.S. citizenship requirements of 49 U.S.C. 40102(a)(15)." I agree with Fed Ex's assessment of the legal limitations on DOT's authority.

If DOT's new standard is allowed to be implemented, there could be serious consequences for our national aviation system, particularly since the most likely foreign investors would be foreign airlines or persons with interests in foreign airlines. Foreign interests could restructure the route system and fleet of a U.S. airline so that the U.S. airline would become, in effect, a "feeder" for the international operations of a foreign carrier. This could limit service and competition in markets served by the U.S. airlines, particularly service to small communities.

There could also be effects on national security: A foreign investor could decide to take an airline out of the CRAF program, or it could accomplish this indirectly by changing the fleet mix of a U.S. airline to reduce the number of large, wide-body civilian aircraft that the Department of Defense relies on to supplement its military fleet in times of national emergencies.

In addition, U.S. airline employees could lose high-quality job opportunities, in favor of employees of the foreign carrier. There could be similar effects on other aviation industry employees. Foreign investors would be inclined to support the purchase of aircraft produced by foreign companies, and to have the airline use foreign repair stations.

The Department's Supplemental Notice of Proposed Rulemaking (SNPRM), issued last week, does *not* change the fact that DOT has stretched its interpretation of "actual control" well beyond the plain meaning of the statute.

The SNPRM proposes several new limitations on foreign control, such as a requirement that an airline's stockholders must retain the right to revoke a delegation of control to foreign investors. These "requirements" are not part of the actual proposed regulation, but are "*obiter-dicta*" discussed in the preamble. Even the discussion of this and other requirements is vague, and would leave the Department with virtually unlimited discretion as to the exact limitation that will be required when the Department is asked to approve a specific proposal for foreign control.

To make matters worse, the SNPRM indicates that the DOT will not use public procedures to decide upon most proposals for foreign control. The exact limitations will be worked out in private negotiations between DOT and the foreign investors.

If the SNPRM becomes final, it is certain that prospective foreign investors will not want to run the risk that their right to control might be revoked. They will propose limitations on the process for revocation to ensure that it will never be exercised. Since DOT strongly supports foreign investment, it will have every incentive to accept limitations that undermine the right to revoke.

Let's be honest with ourselves, in the real world, it is not realistic to rely on shareholder action as a check on foreign control. They don't do it even in domestic affairs. Shareholders of major corporations do not ordinarily vote on policy issues. A corporate law expert has advised me that getting a shareholder vote to revoke a delegation of control to foreign investors would be about as difficult as passing an amendment to the U.S. Constitution!

Whatever the specifics of the power to revoke, it will be meaningless in most cases. How likely is it that shareholders will exercise a power to revoke when the consequences might be the withdrawal of the foreign investor's financial support, or expensive litigation over whether the power to revoke was properly exercised?

I have been deeply concerned, as have many of my House colleagues, that under the DOT's proposal, the foreign interests that controlled an airline would also control safety, security, and the CRAF program. The SNPRM attempts to meet our concerns by claiming that under the proposal, foreign interests would not be allowed to supervise the managers responsible for safety, security or CRAF, or to control their budgets, and compensation. This seems unrealistic. Does this mean that a Vice President for Security would have unlimited budget authority and unfettered authority to set his or her compensation? In reality, when it comes to a specific case, a foreign investor is likely to insist on conditions that do not isolate it from all decisions affecting safety, security or CRAF.

Late last year, 189 of my colleagues, including Chairman Don Young, joined me to introduce H.R. 4542, which prohibits the DOT, for 1 year, from issuing any final decision or final rule on the NPRM that would change its interpretation of what constitutes "actual control" of a U.S. airline.

I urge the Senate to preserve the language in the defense supplemental appropriations that would prohibit the DOT from implementing this rule for the rest of the fiscal year. We must ensure that any changes in the law will come from Congress—not by Administrative fiat.

If, in the unfortunate circumstance that the DOT proposal is made final before Congress can act, I strongly believe that the final rule will have a short life span. The new policy is certain to be challenged in court. I cannot imagine a court agreeing with the Department that it is consistent with the "plain meaning" of the requirement of "actual control" to only require control of an airline's decisions on safety, security and the CRAF program. Nor would a court accept the DOT's argument that the requirement that the President of an airline must be a U.S. citizen can be satisfied by a President in name-only, with no authority over commercial decisions.

Thank you very much for this opportunity today to discuss this very important issue.

Senator BURNS. Thank you, sir.

Any questions of our distinguished members from the other side?

[No response.]

Senator BURNS. Thank you very much, gentlemen. We appreciate that very much.

We have been joined by Senator Lott, who used to chair this Subcommittee.

Senator Lott, do you have an opening statement, or——

STATEMENT OF HON. TRENT LOTT,
U.S. SENATOR FROM MISSISSIPPI

Senator LOTT. Not at this time, Mr. Chairman. I'd like to hear what these witnesses have to say.

Senator BURNS. That's fine.

Now we call to the table the Honorable Jeffrey Shane, Under Secretary for Policy, United States Department of Transportation, from right here in this 17 square miles of logic-free environment.

Thank you very much. Secretary Shane, nice having you with us today.

STATEMENT OF HON. JEFFREY N. SHANE, UNDER SECRETARY OF TRANSPORTATION FOR POLICY, DEPARTMENT OF TRANSPORTATION

Mr. SHANE. Thank you very much, Mr. Chairman, I'm delighted to be here to represent the Department of Transportation—of course, Secretary Mineta, who sends his regards to the panel.

I have a prepared statement, Mr. Chairman, which I'd like to have incorporated in the record, and I'd like to sum it up, if I may.

Senator BURNS. It will be a part of the record. You may summarize, if you so—if you choose.

Mr. SHANE. Thanks.

Because we're in the middle of a rulemaking process, I think every member of the panel knows, we've just issued a supplemental notice of proposed rulemaking. I can't tell you what final decisions are going to come out of the Department of Transportation, and I literally don't know, which is why I can't tell you, but, of course, we're all aware of the importance of this initiative, and we recognize the Committee's interest in it. And, for all of those reasons, we wanted to share, to the extent possible, the Department's thinking in proposing to refine the administrative policies that guide our citizenship reviews.

In the initial notice that we published last November, we proposed that under certain circumstances, the Department would move away from more than 60 years of administrative interpretation of the statute which allowed no semblance of foreign control in determining whether U.S. citizens were in control of U.S. airlines. That interpretation, which was never required by the words of the statute, has had the effect of relegating foreign investors to a largely passive role in any U.S. airline unable to participate in the commercial decisionmaking affecting the value of their own investment. Despite occasional efforts to introduce some measure of flexibility, that policy has remained essentially intact. The net result of that policy has been to discourage foreign citizens from investing even that which the statute allows. But the Civil Aeronautics Board and the Department of Transportation have always required—and what the statute now says explicitly after its 2003 amendment is that U.S. airlines must be under the actual control of U.S. citizens. What the initial notice proposed to do was to explore whether more foreign investment within the numerical limits always allowed under the statute might be encouraged if, in applying the actual control requirement, we adopted a less forbidding and less categorical policy regarding the ability of foreign investors to participate in the commercial decisionmaking of U.S. airlines.

Let me emphasize that our proposal is not designed to loosen the statutory caps or to encourage more investment than the statute allows. It is designed not to encourage increased investment. It is designed to encourage some investment.

I also want to emphasize that the only decisionmaking that would be affected by the proposal is commercial decisionmaking. As you have heard, ultimate responsibility for management decisions relating to safety and security and U.S. airlines' participation in Department of Defense programs including, of course, the CRAF program, would be reserved exclusively to U.S. citizens. We chose to issue a supplemental notice, because we're now proposing changes to our original proposal in response to comments, in response to concerns that have been expressed by interested parties, including other Federal agencies and, of course, by Members of Congress. We think these changes will serve to clarify both our intent and the way the proposed rule would work in practice if we finally adopt it.

We are interested in hearing people's reactions to the changes over the course of the next 2 months. We think the economic bene-

fits at stake are substantial. Our proposal is designed to enhance U.S. airline access to the global capital marketplace, consistent with our statutory obligation to encourage U.S. airlines in their ability to attract capital. We think the proposal would have a long-term positive effect on the industry by expanding the pull of investors, introducing new competition among investors, providing U.S. airlines with better investment terms, and enhancing strategic partnerships between U.S. and foreign airlines. The changes could lower the cost of capital for U.S. airlines and enhance asset values. This proposal does not envision a one-way street for investment. However, one of the proposal's most important provisions is a reciprocity requirement designed to encourage further liberalization of the market for airline capital, just as we have liberalized the market for airline services. It will offer U.S. citizens opportunities to invest abroad in foreign airlines—under the proposal, only foreign investors who are from countries that have Open Skies Agreements with the United States—and that permit similar investment opportunities for U.S. investors, and their airlines would be eligible for this approach.

A proposal, therefore, would not only afford U.S. carriers the opportunity to tap more global sources of capital, but U.S. carriers would be able to enhance their international presence by investing overseas in ways that they cannot do in most places today. In other words, our proposal carries with it the prospect of far more liberal treatment of airline investments everywhere, resulting in more robust international alliances, a healthier and more efficient global airlines industry, more competition for the benefit of travelers and shippers everywhere, and expanded job opportunities for airline employees.

Please understand, nothing in the proposal that we have on the street right now would allow the sale of U.S. airlines to foreign interests. Under the proposal, U.S. citizens would still have to own 75 percent of the voting stock of the airline, would still make up two-thirds of the board of directors, would still include the President and two-thirds of the managing officers of the company, all as prescribed by statute today. U.S. citizens would have to retain actual control of the airline. Any delegation of commercial decision-making authority to the foreign investor would have to be revocable. Again, decisions relating to safety, security, and national defense, and the carrier's organizational documents, could never be delegated and would have to be controlled exclusively by U.S. citizens.

I want to emphasize that we've proposed this interpretation because we believe it is justified on its own merits due to the potential benefits for the U.S. airline industry. At the same time, the European Commission and its 25 Member States have stated publicly that the results of this rulemaking will be a factor in their decision whether to agree or not to a proposed U.S.-EU Air Services Agreement.

That Agreement has the potential to fundamentally transform the framework for transatlantic air services, dramatically increasing the quality of competition in the market. It would benefit U.S. airlines, consumers, and communities on both sides of the Atlantic,

transcending anything we have yet achieved through our existing Open Skies accords.

If we do decide, therefore, to adopt a final rule along the lines of our proposal, a transformational Open Skies Agreement with Europe could be an important byproduct. Globalization of the airline industry has already begun. It is time that U.S. airlines are permitted to take advantage of the opportunities waiting for them.

I thank you very much for the opportunity to share the Department's transportation prospectus with you. And I, of course, am more than happy to answer your questions.

[The prepared statement of Mr. Shane follows:]

PREPARED STATEMENT OF HON. JEFFREY N. SHANE, UNDER SECRETARY OF TRANSPORTATION FOR POLICY, DEPARTMENT OF TRANSPORTATION

Thank you, Mr. Chairman, members of the Subcommittee. I am pleased to appear before you today in response to your invitation to review the status of DOT's rulemaking regarding "actual control" of U.S. air carriers. As you know, it is unusual for DOT to appear at a hearing concerning an ongoing rulemaking. Because we are still in the middle of the rulemaking process, having issued a supplemental notice of proposed rulemaking just last week, I cannot tell you what final decisions the Department is going to make because I don't know. We are all aware of the importance of this initiative, however, and we recognize the Committee's interest in it. For those reasons, I wanted to share, to the extent possible, the Department's thinking in proposing to refine the administrative policies that guide our citizenship reviews. Because the comment period for the SNPRM is open, I can only discuss general themes and policies in the rulemaking. I cannot address substantive issues or comments made to the Notice published last November or to the Supplemental Notice. But I will say that we carefully reviewed the comments we received, and considered them when drafting the Supplemental Notice, as we will do with any comments we receive in the next 2 months. Even though I must be relatively circumspect in my own comments here today, I will do my best to be responsive to you within those parameters.

With the publication of this Supplemental Notice, we are encouraging a thorough and broad-based debate. We chose to issue a Supplemental Notice because we have made substantive changes to our original proposal in response to comments and concerns expressed by interested parties, including other Federal agencies and Members of Congress. We believe these changes will serve to clarify both our intent and the way the proposed rule would work in practice if we finally adopt it. We are interested in hearing people's reactions to those changes.

In the initial Notice published last November, we proposed that, under certain circumstances, DOT would move away from more than sixty years of administrative interpretation of the statute, allowing "no semblance of foreign control" in determining whether U.S. citizens were in control of U.S. airlines. That interpretation—not required by the words of the statute—has had the effect of relegating foreign investors to a largely passive role in any U.S. airline, unable to participate in the commercial decisionmaking affecting the value of their own investment. Despite occasional efforts to introduce some measure of flexibility, the policy has remained essentially intact.

What the Civil Aeronautics Board and DOT have always required—and what the statute now says explicitly after its 2003 amendment—is that U.S. airlines must be under the actual control of U.S. citizens. What the initial Notice proposed to do was to explore whether more foreign investment (within the numerical limits always allowed under the statute) could be encouraged if we, in applying the "actual control" requirement, adopted a less forbidding, less categorical policy regarding the ability of foreign investors to participate in the commercial decisionmaking of U.S. airlines.

I want to emphasize that the only decisionmaking that would be affected by the proposal is *commercial* decision-making. Ultimate responsibility for management decisions relating to organizational documents, safety, security, and U.S. airlines' participation in Department of Defense programs—including CRAF—would be reserved to the U.S. citizen investors only.

The economic benefits at stake are substantial. Our proposal is primarily designed to enhance U.S. airline access to the global capital marketplace. Our proposal would have positive and long-term effects on the industry by expanding the pool of qualified investors, introducing new competition among investors to provide U.S. airlines

with better terms, and enhancing strategic partnerships between U.S. and foreign airlines. These changes could lower the cost of capital for U.S. airlines, which would be enormously beneficial for the U.S. industry as it restructures to meet the demands of the global marketplace. Additional investment opportunities in the airline industry can and will strengthen U.S. airlines.

This proposal does not envision a one-way street for investment, however. One of the proposal's most important provisions is a reciprocity equirement designed to encourage further liberalization of aviation markets and offer U.S. citizens opportunities to invest abroad in foreign airlines. Under the proposal, only foreign investors who are from countries that have Open Skies Agreements with the United States and that permit similar investment opportunities for U.S. investors in their airlines would be eligible for this approach. I call this one of the proposal's most important provisions because it has the potential to encourage a more liberal approach to capital flows in aviation on a global basis. It would not only afford U.S. carriers the opportunity to tap more global sources of capital; but also under the reciprocity requirement, U.S. carriers, either alone or as part of a larger group of U.S. investors, would be able to enhance their international presence by investing in foreign carriers.

Thus, our proposal carries with it the prospect of far more liberal treatment of airline investments everywhere, resulting in more robust international alliances, a healthier and more efficient global airline industry, more competition for the benefit of travelers and shippers everywhere, and expanded job opportunities for airline employees.

At a February hearing conducted by the House Subcommittee on Aviation, opponents of the rulemaking testified that the proposal will relegate U.S. airlines to mere "feeder" status, and that the lucrative and prestigious long-haul international flights will migrate to the foreign investor airlines. In contrast to that fearful prediction, I have seen an investment banking report from Europe alleging that, by leaving untouched the statutory 75-percent minimum U.S. voting stock ownership requirement, our proposal is intentionally designed to ensure that U.S. carriers remain dominant players in the global airline industry.

I don't know whether U.S. carriers will dominate global aviation in the future, but we do believe that our proposal would, in fact, strengthen the U.S. airline industry without undermining any of our important national interests.

What we have done in the Supplemental Notice is to build upon and clarify the ideas we proposed in the initial Notice of Proposed Rulemaking. In light of the comments and concerns expressed about the NPRM, we consulted with other Executive agencies, particularly the Departments of Homeland Security and Defense, as well as our own Federal Aviation Administration, to refine our proposal to better ensure not only that U.S. airlines remain under the actual control of U.S. citizens, but also that they remain safe, secure, and available to meet the Nation's defense needs. The areas that would continue to be scrutinized for exclusive, non-delegable U.S. citizen control—safety, security, and national defense—would require DOT to strictly review the airline's structure, with particular focus on the carrier's fundamental organizational documents, which must also remain under exclusive U.S. citizen control.

In the Supplemental Notice, we have refined our previous proposal in part to make it clearer to airlines that might seek to benefit from our revised approach. Our proposal sets out two prerequisites to a foreign investor's eligibility to take advantage of this new interpretation: Does the foreign investor's home country have an Open Skies Agreement with the United States? If it does, then: Does the foreign investor's home country have a similarly open investment regime in its airlines for U.S. investors? Only if these two questions were answered in the affirmative would the Department commence a review of the carrier under this new interpretation. If the answers are "Yes," then the questions that would be examined are:

- Do the corporate documents—the charter, the by-laws, the basic agreements, etc.—reflect actual control by U.S. citizens of those documents?
- Is the foreign investor delegated any *commercial* decision-making authority?
- Is this authority ultimately revocable by the U.S. citizen majority owners?

To ensure full control by U.S. citizens of the carrier's activities in three key areas:

- Are U.S. citizens clearly and completely in actual control of all decisions having to do with the carrier's policies and implementation with respect to safety?
- Are U.S. citizens clearly and completely in actual control of all decisions and activities having to do with the carrier's policies and implementation with respect to aviation security?

- Are U.S. citizens clearly and completely in actual control of all decisions having to do with Department of Defense programs?

And remember, the burden of proving all of these requirements would remain with the applicant. If the applicant could not meet that burden, it could not be licensed as a U.S. air carrier. Similarly, an already licensed carrier that received a significant offshore investment would be subjected to what we call a "continuing fitness review" including the same requirements and the same burden of proof. Failure to meet that burden would call into question the carrier's continuing eligibility to hold an air carrier certificate.

While U.S. citizens will continue to exercise "actual control" of every U.S. airline, the only areas that could not be delegated to foreign investors would be these four—safety, security, national defense, and the carrier's organizational documentation. Pursuant to arrangements with the U.S. citizen majority owners, foreign investors would be permitted to participate in the airline's *commercial* decision-making in a more meaningful way.

I want to emphasize several points. First, the physical safety and security of every U.S. airline would be under the close supervision and control of the FAA, TSA, and other relevant authorities, as they have always been. CRAF carriers would also be subject to inspection by the military exactly as they are today. Second, the Department has a long history of closely examining carriers' structure and operations to ensure that actual control remains in the hands of U.S. citizens; this function should actually be made easier by a narrower focus on the areas of corporate documents, safety, security, and defense activities for investments from citizens of qualified countries. Third, we think carriers that receive foreign investments as the result of the new rule, if we adopt it, are likely to be more careful than ever to ensure that all CRAF-related functions remain securely in U.S. hands, to avoid any question.

Under DOT's proposal, U.S. citizens would have to continue to be in "actual control" of a U.S. airline for it to be eligible to retain its certificate. As the statute dictates—and we are in no way proposing to alter or change the statute—U. S. citizens would have to own 75 percent of the voting stock of the airline, would make up two-thirds of the Board of Directors, and would include the President and two-thirds of the managing officers of the company. U.S. citizens would ultimately control the decisionmaking of the airline; any delegation of decision-making authority to the foreign investor *would have* to be revocable and *could not* be in the spheres of safety, security, national defense, or organizational documents.

In addition, we are not proposing any change in our criteria for ascertaining "control" for airlines not meeting the conditions for using the proposed interpretation and for those areas that we examine for airlines that do meet the conditions. The Advance Notice of Proposed Rulemaking published seven non-exclusive criteria that DOT's Inspector General cited in his report as being generally used by the Department. We intend to continue to use those criteria.

The potential benefits of DOT's proposal go well beyond enhancing the availability of capital to U.S. airlines. The international alliances that currently exist among U.S. and foreign airlines represent a surrogate for the kind of globalization that occurs around the world in other networked industries through conventional mergers and acquisitions. New opportunities for liberalized air services agreements bring competition home in the form of competitive prices to consumers and shippers.

I want to emphasize that we have proposed this interpretation because we believe it is justified on its own merits due to the potential benefits for the U.S. airline industry. However, the European Commission and its 25 Member States have stated publicly that the results of this rulemaking will be a factor in their decision whether to agree or not to a proposed first-phase U.S.-EU Air Services Agreement. Let me briefly address this Agreement, which is currently pending before the EU Transport Ministers.

The Agreement has the potential to fundamentally transform the framework for transatlantic air services, dramatically increasing the quality of competition in the market. It will benefit consumers and communities on both sides of the Atlantic, transcending anything we have yet achieved through our existing Open Skies accords. The Agreement will also enhance the quality of transatlantic cooperation in the areas of safety and security, competition law and policy, and environmental and consumer protection. Moreover, the Agreement represents only a first stage of opening markets and enhancing cooperation.

Completion of the U.S.-EU Agreement would not only enhance airline competition across the Atlantic, but would also set a new standard for liberalization around the world. This Agreement will enable U.S. and European airlines—singly and in combination—to capitalize on the importance of a newly unified transatlantic market and develop a truly global presence. Success here can be expected to encourage emu-

lation in other regions, accelerating the attainment of more open markets for international air services.

The globalization of the aviation industry has already begun; it's time that U.S. airlines are permitted to take advantage of the opportunities waiting for them.

Thank you for the opportunity to share the Department of Transportation's perspectives with you. I would be pleased to respond to your questions.

Senator BURNS. Thank you very much, Mr. Shane.

I want to ask you one question, then I'm going to switch to the Chairman of the full Committee. He has a statement to make, here, in about 20 minutes, and has to get to the floor, and then I will sacrifice my time and then go to Senator Dorgan.

I just have one question that probably could start this debate. What would further liberalization and foreign capital mean to rural states like Montana? Do you see any change that would anticipate that foreign investors will care more about routes in rural America, opposing those thoughts of holding onto the high traffic airlines like New York, Chicago, and Los Angeles? What do you think would happen to even our hub system that is in place now that has been very beneficial, to be honest with you, to areas like my state and remote areas with low-density population?

Mr. SHANE. We think the prospects for rural air services are actually enhanced by the possibility of bringing more capital to the airline industry. Recall the only incentives that would be permissible in encouraging any foreign investment would be purely commercial incentives. That is, the incentive to make money in the airline business. To the extent that an investment is attractive to a foreign citizen, it will be because there is the possibility of earning a return on that investment. It is the same motivation, Mr. Chairman, that would motivate a U.S. citizen. So, the fact of the passport that the investor holds is not going to have any impact on the plans that the investor has for the airline.

Senator BURNS. We'll—I was going to move to the Chairman of the full Committee. You have no questions, then?

The CHAIRMAN. No, thank you.

Senator BURNS. Senator Dorgan?

Senator DORGAN. Mr. Chairman, I come from a really small town, so I'm having trouble understanding all of this.

It appears to me that you're suggesting, with your rule, that a foreign entity can come in and pay a substantial amount for a big piece of the action, but, legally, they would still be defined as having a smaller piece of the action.

Mr. SHANE. No——

Senator DORGAN. Is that what you're saying?

Mr. SHANE.—Senator, they would be limited by the statute of how much they could invest. And that——

Senator DORGAN. I understand that.

Mr. SHANE.—that's 25 percent, maximum, in terms of the voting shares. If they wanted to invest money and not get any voting power for it, we've allowed, for Open Skies investors, up to 49 percent, but that has no impact on governance. So, we're really only talking about the 25 percent which is still in place.

Senator DORGAN. So, you have decided, down at the agency, this is something within your purview, it is not something that is required to be done by the United States Congress?

Mr. SHANE. Well, I want to emphasize, we haven't decided anything. We have made a proposal. We believe the proposal is within the purview of the Executive Branch. We're reinterpreting an interpretation, if you will, that was an administrative interpretation in the first instance. The statute didn't say anything about what the words "actual control" mean, whether it be possible for foreign citizens to participate in commercial decisionmaking. That was a CAB decision that said, "No. No semblance of influence, no shadow of influence, no semblance of foreign control." Those are administrative constructs over the statute. The statute has to be interpreted, we think, in keeping with other statutory obligations that we have within the Federal aviation laws. And one of those statutory obligations is to facilitate U.S. airlines in their efforts to attract capital, facilitate U.S. airlines in their efforts to be profitable, to facilitate new entry into the airline industry, to foster a competitive airline industry. The attraction of capital into the airline industry is part and parcel, we think, of the large *corpus* of obligations that the Congress has vested in the Department of Transportation.

Senator DORGAN. Yes, the need to attract capital doesn't in any way change the underlying law that says "actual control."

But let me ask another question. What if a foreign entity, perhaps a foreign government that owned its own airline—there are some of those, is that correct? Would they be prevented from being involved in this play?

Mr. SHANE. Yes. The reciprocal obligation that we have insisted upon as part of the proposal would say that only if U.S. citizens can invest in airlines of that country would we be receptive to investments from investors in that country. And if it's a state-owned airline, it's very unlikely that we'd have that ability.

Senator DORGAN. But they would not be prohibited. Well, let me——

Mr. SHANE. They would——

Senator DORGAN.—let me ask it——

Mr. SHANE.—prohibited.

Senator DORGAN.—a different way.

Assume a foreign carrier decides, "We want to make a substantial or a sizable investment in a domestic carrier here in this country, and we've decided we want to change the type of equipment, and we would like to essentially compete in several large city pairs." That carrier happens to fly in small communities in Alaska, North Dakota, and Montana, and has service with DC–9s and some RJs and so on. But the foreign carrier decides, "I want to change the nature of this company. I'm going to invest in it, and I'm going to run it. I'm going to decide routes and fleets. And I've decided I'm not interested in rural service anymore." What remedy do we have?

Mr. SHANE. Well, you would have no remedy, any more than you would have if U.S. investors decided to do all of that. Again, U.S. investors and U.S. owners are in charge of this airline. Any kind of delegation of authority that would give a foreign investor some say over fleet selection or route selection would have to be specifically with the agreement of the majority owners, the people that own 75 percent of the voting shares of the company. Those are all U.S. citizens, under the law.

Senator DORGAN. Now I'm very confused, because my understanding from your testimony and from what I'm told this proposal suggests is that the foreign interest that would be running these companies, if they made a significant purchase in a domestic carrier, would decide schedules and decide the kind of airplanes they would use and so on. That would be the kind of management control they would have to run their airline.

Mr. SHANE. We're talking about the full range of logical possibilities. We don't know. It would be up to the U.S. owners and managers of the company to decide what they felt like agreeing with foreign investors would be OK for foreign investors to decide. The U.S. citizens remain in control, Senator.

Senator DORGAN. So, the foreign investors come in, and they invest sufficient money in a domestic carrier so they can run the carrier, presumably, without more than 25 percent control, and they're not going to determine what routes they serve and what kind of airplanes they use?

Mr. SHANE. They would only be able to determine any of those issues with the express agreement of the majority shareholders, which——

Senator DORGAN. You know something? I don't think I'm getting a straight answer from you, Mr. Shane. I don't think that's at all in concert with what your proposal is. Now maybe I am wrong about this, but from what I understand this proposal is that it's completely the opposite of what you just described.

Mr. SHANE. It's exactly what I've described. Everybody is in agreement that U.S. citizens must remain in actual control of U.S. airlines. There is no way that anybody from the Administration can tell you that U.S. citizens would remain in actual control of U.S. airlines unless they are in a position to decide whether or not foreigners will have——

Senator DORGAN. Then why do you need a proposal?

Mr. SHANE. Because today under the old 66-year-old policy, developed by the CAB in 1940 as we were preparing for war, citizens of foreign countries can have no say whatsoever in anything having to do with the commercial management of a U.S. airline.

Senator DORGAN. You want to give them a say. Is that correct?

Mr. SHANE. In order for them to——

Senator DORGAN. With respect to scheduling?

Mr. SHANE.—at least have some incentive to invest capital or to compete for investments in U.S. airlines for the health of the U.S. airline industry, yes, Senator.

Senator DORGAN. Mr. Chairman, I don't mean to belabor this at great length, but I think the answer, based on what I know and have looked at, the answer is that if a foreign carrier comes in, under your proposal, and makes a significant investment, and decides they're going to try to run this company, which you would allow, they're going to decide what kind of company they're going to run, what their schedule is going to be, what kind of fleet they're going to have. That's my understanding.

Mr. SHANE. It's wrong. Senator, they——

Senator DORGAN. Well, I'm——

Mr. SHANE.—can only invest 25 percent.

Senator DORGAN. I'm sorry, I can——

Mr. SHANE. They can have no more than 25 percent of the voting shares.

Senator DORGAN. I understand the investment issue. That wasn't my question.

Mr. SHANE. They cannot run the company with 25 percent, Senator. That is the clearest——

Senator DORGAN. Well, what's your——

Mr. SHANE.—possible statement I can make.

Senator DORGAN. What are you then offering a foreign investor? You're offering——

Mr. SHANE. The ability to agree with the majority shareholders that they might want to have something to say about the management of the company.

Senator DORGAN. And what is that they're going to have to say?

Mr. SHANE. Whatever the U.S. citizens who run the company and own the company say that should be permissible.

Senator DORGAN. Your proposal offers them the ability to say something. What are you going to tell us they're going to say to the domestic company that—which they have now just purchased, in part, and have decided to run? What are they going to have to say in that purchase?

Mr. SHANE. This would be an arm's-length commercial decision in the best interest of the shareholders of the company. The directors and officers of the share—of the company have a fiduciary responsibility to shareholders. This is purely commercial. Everybody is going to have the same incentive, and that is to make money with this company.

Senator DORGAN. Mr. Shane, I don't mean to browbeat you, but it appears to me this is an illusion of some type. And, frankly, I'm very interested in aggressive, robust, good airline service across this country, and I'm very worried about this proposal.

I appreciate your coming, but I don't think I got a straight answer, Mr. Shane.

Senator BURNS. Senator Lautenberg?

Senator LAUTENBERG. Mr. Chairman, Senator Dorgan is not wrong. The fact of the matter is that it's truly escaping reality when we divide up the chart as we see it here, because, though there will be an American ostensibly in charge of security, safety, et cetera, those four categories—but is that American executive going to say to the CEO of this company, who's in Paris, that, "No, no, no, you don't get it, CEO. The fact is that I'm sticking up for the contract as it exists, and we're going to do these things." That doesn't sound like a very efficient management structure to me. And we have something called the Essential Air Service that both our colleagues have talked about, and a lot of American airlines aren't crazy about that Essential Air Service. The Federal Government now pays a fee for that. Will we continue to do that, I don't think so. I mean, business is business, is what we're saying here. And if there is an agreement between a greedy American shareholder, Senator Dorgan, if—if there's a greedy American shareholder—and there have been a couple who ventured into the airlines business and stripped them of their assets and didn't continue to find money for operations. If this greedy person got an agreement with the 25 percent foreign shareholder and said, "Hey, you

know what? Suppose we bought a few more Airbuses or Embraers or whatever they are—airplanes made outside the country," because that's a category that is reserved for the ownership and for the management of the company, and 25-percent block is a pretty significant block, even though it's the voting shares. And the thing that, frankly, I think is being missed here is, the way technology is developed and transportation is designed is that our aviation system is like an extension of an American highway, except it's in the skies and, as a consequence, gets us an ability to extend our military power when we need it. We wouldn't let a foreign government decide which way our highways go, but, in this position, with the investment they have, I think we'd be in a precarious position to really exert the kind of interest that we want upon the foreign investor, the 25 percent investor. We've had this battle here about who does the screening. We know that it was done very badly by private industry, and, as a consequence, necessitated a great change into the DHS structure. I don't think those things are particularly clear.

Once again, I'd look to the history of the airline industry. I mentioned before that we had put some $20 billion in the last 5 years to keep the industry from—keep major airlines from going bankrupt altogether. And there have been a couple of—I'll call them robber barons who went in there and took the assets in Texas in one place and other places around the country, and stripped these airlines of their opportunity to continue. And what happens if it's not an absolutely free market and the foreign investor will have substantial voice? They can buy all of the nonvoting shares that they'd like to have. Is that correct?

Mr. SHANE. Citizens of—Open Skies partners are allowed to get up to 49 percent of the total equity of the company, including nonvoting.

Senator LAUTENBERG. Including nonvoting.

Mr. SHANE. But not more than 49.

Senator LAUTENBERG. So, to me, it seems like it's an asset that we have to preserve our—all of our decisionmaking in. And the airline business now, competitive as it is, we have to fight like the devil to get entry into some of the better airports, or the busier airports in the world. It's getting better, but no one is being deprived of opportunities. So, maybe we ought to discuss it in terms of routes instead of ownership, instead of equity, and continue American ownership of these essential parts of our society.

Thank you.

Senator BURNS. Still no questions from this side over here? What are you guys just taking the afternoon off over here or something?

[Laughter.]

The CHAIRMAN. Well, I'm waiting for the panel. Mr. Chairman——

Senator BURNS. Oh, you're waiting for the panel. Well, I'll get to it in just—I've got a couple—yes, I'm sorry.

The CHAIRMAN. I have a series of questions I'm going to ask you to allow me to submit to the witnesses, because I have to be to the floor, but I—we do want to listen to the panel. That was the idea.

Senator BURNS. OK, I'll—I just got a—along with the questions that come from Senator Lautenberg and Senator Dorgan, you state

in this supplemental rule that delegation of decisions can be revoked by company shareholders. When you looked into this, how often did—in the real world, did shareholders revoke or change such decisions, any actions that they may have taken? And did you base this on previous models, or have you discussed this with Wall Street?

Mr. SHANE. We've discussed it informally, I think, over many years with——

Senator BURNS. OK.

Mr. SHANE.—with Wall Street investment bankers, but this is predicated mostly on just administrative notice of what happens within corporations. It is certainly possible for majority shareholders to terminate relationships with minority shareholders where minority shareholders are exercising more than the authority that their shares would normally accord them. So, I don't think there is any controversy about the ability of the majority to revoke, but we don't have to really leave any of that to chance. The Department would be reviewing the citizenship of every airline which had substantial foreign investment, specifically with an eye to determining whether or not it complied with the tests that are laid out in the proposal, if, indeed, we adopt this proposal as a final rule.

Senator BURNS. Tell me, does it concern you about the CRAF whenever you started to make—to write this rule? Does that concern you about our arrangement with our commercial carriers?

Mr. SHANE. Absolutely. The first place we went when this proposal was still a gleam in our eye was to the Department of Defense to talk to them about it before it was a live proposal. I spent, Mr. Chairman, if I can just be personal for a moment, 7 years, while in the private sector, as Chairman of the Military Airlift Committee of the National Defense Transportation Association. I have worked with the CRAF probably for 15 years, and understand its equities completely. They're our heroes in the Air Mobility Command and in USTRANSCOM, and they're doing a marvelous job for America every day of the week. The last thing in the world Secretary Mineta would want, and the last thing in the world that I would want, or anybody else at the Department, would to compromise the CRAF program in any way, shape, or form. So, we—that is the number one priority for us, making sure that we enhance and not detract from the CRAF program's prospects.

Senator BURNS. Well, we thank you for—does anyone else have any questions for the witness?

Senator PRYOR. Mr. Chairman, I do. I'm sorry I was late joining the——

Senator BURNS. Senator——

Senator PRYOR.—hearing.

Senator BURNS.—good to see you.

STATEMENT OF HON. MARK PRYOR,
U.S. SENATOR FROM ARKANSAS

Senator PRYOR. Thank you. I'll try to make it very brief.

Mr. Shane, if I may, I know that three of the things you look at and you consider as part of this process are the economics, the safety, and the security aspects of an airline. Do you, or does your agency, have a clear delineation about where one of those starts

and the other one ends? Because, to me, it seems that they're intertwined. When you talk about economics, safety, and security, it seems that some of those are inextricably linked, and they overlap. But I'd like to hear your thoughts on that.

Mr. SHANE. Well, let's just take safety as an example. We absolutely think there has got to be a bright line between the safety management of an airline and anything else that goes on in the airline. The pilot in the cockpit is the safety officer on that aircraft, along with the rest of the crew. And that captain has an absolute obligation to provide safe service. When a little light goes on in the cockpit suggesting that there's a mechanical problem somewhere, the captain does not call the Chief Financial Officer of the company, he doesn't call the marketing department. He doesn't call anybody. He makes a decision based on safety. And if the FAA, in its regulation of safety, thought that there was any compromising of that independence, that airline would probably be grounded. So, there is a long history of drawing bright lines between safety, on the one hand, and the commercial operations of an airline, on the other.

Senator PRYOR. When you talk about the commercial operations, you mention the pilot, but what about the general maintenance? There are a lot of economic aspects to the maintenance of these airplanes. And, as you well know, that can be very expensive. So, again, maybe there is a bright line, but I'm not so sure. I'd like to know, for the Committee's understanding, I'd like to know where those lines are drawn so that maybe we could get comfortable with this; whereas, some of my colleagues may not be right now. Is that fair enough? Can you provide that to the Committee?

Mr. SHANE. Yes, Senator, thank you.

Senator PRYOR. Another question I have is in regards to the ability to contract. In other words, if a foreign investor group comes in, is there anything in your proposal, or what you would like to see happen—is there anything that might prevent the airline from entering into a contract that might give them various decisionmaking authority in various areas, maybe more than the 25 percent stake they may have, but where, in effect, they may actually have actual control of the airline? Is there anything that would prevent entering into such a contract?

Mr. SHANE. Well, the Department would insist that the majority shareholders and the majority of the board remain in actual control of the airline. U.S. citizens must be in actual control of the airline at all times. If there is to be any delegation to the foreign investors or foreign citizens of any aspect of the commercial operations, it has got to be pursuant to an agreement which gives them that ability, but that agreement is still subject, at the end of the day, to the ultimate decisionmaking of the majority shareholders, the U.S. citizens, who, if they don't like the outcome of that activity, if they don't think it's delivering value to the airline or to its shareholders, are in a position to terminate it. That's what the Department's review would ascertain. That's the only way we can sit here and say with a straight face that U.S. citizens remain in actual control, notwithstanding the fact that there are foreign citizens exercising some influence over some commercial aspects of the company.

Senator PRYOR. Well, the reason I ask that is because I can see a circumstance in which a U.S. airline is in distress, financial distress, and some foreign investment group comes in and says, "We'll buy up to 25 percent," and basically bail out the airline, get you back on financial footing. They may have, in my view, much more influence with that airline, because, in effect, they save the airline, more so than what the 25 percent stake may be. Twenty-five percent is a big stake in any company, but they may have more influence than that, and the Board may defer to them in ways that they wouldn't otherwise. I have that question. Would you comment?

Mr. SHANE. Well, I want to be clear. That is what we contemplate. If the board—whether it was a bailout situation or simply an arm's-length relationship with new investors, if the board—if the majority of the board felt that having the investor play a more substantial, meaningful role in the commercial operation of the airline, that that would be in the interest of shareholders, even beyond the 25 percent interest that they own, they would be permitted to do that. That would be the change that we are proposing. Today, under—in the present policy, there is no possibility of attracting that investment, because there is no possibility of giving any foreign investor anything to say—any way of protecting his or her investment.

Senator PRYOR. Mr. Chairman, I'm out of time. Thank you.

Senator BURNS. Thank you.

And thank you, Mr. Secretary. I appreciate your appearance here today. And I'm sure there'll be further questions on this. And if you could respond to the Committee and the individual Senator, I'd certainly appreciate that.

Mr. SHANE. We will, Mr. Chairman. Thank you very much.

Senator BURNS. Thank you very much.

Now our second panel today, made up of Mr. Frederick Smith, Chairman, FedEx Corporation, of Memphis, Tennessee; Mr. Jeffrey Smisek, President, Continental Airlines, Houston, Texas; Mr. Michael Whitaker, Senior Vice President—Alliances, International and Regulatory Affairs, for United Airlines; and Captain Duane Woerth, President, Air Line Pilots Association, from here in Washington, D.C.

Gentlemen, we welcome you to the Committee today and look forward to your testimony.

Captain, good to see you again.

We'll start off, today, with this panel, with Mr. Frederick Smith, FedEx Corporation, out of Memphis.

So, Mr. Smith, thank you very much for coming today.

STATEMENT OF FREDERICK W. SMITH, CHAIRMAN, PRESIDENT, AND CEO, FEDEX CORPORATION

Mr. SMITH. Thank you, Mr. Chairman. On behalf of 260,000-plus folks that make their living with FedEx, we're pleased to be represented at this hearing.

FedEx Express, our largest operating company, is the largest transporter of goods by air in the world. It operates the largest fleet of wide-body airplanes in the world, the largest fleet of cargo wide-body airplanes of any fleet in the world. It provides over half of the DOD Civil Reserve Air Fleet cargo airlift. And, in fact, dur-

ing the Desert Storm/Desert Shield operations, moved over 30 percent of all the cargo that was moved into the theater in support of U.S. operations. We operate throughout the world, with extensive networks in Europe, across the Atlantic, into Latin America, across the Pacific, intra-Pacific, through our hub in Manila, the Philippines, and between Asia and Europe. We are very familiar with the history of the aviation bilateral system that Congressman Oberstar did such a good job of explaining. As he noted, the United States tried to get a multilateral regime and—over the objections of the British and others. And, in that last analysis, a bilateral regime was adopted. This has resulted in some 10,000 separate aviation bilateral treaties. And, over the years, this bilateral system has been an effective tool for carriers and governments who want to protect vested interest to restrain competition and progress in the aviation markets. We, at FedEx, are the product of deregulation and have worked hard to achieve Open Skies Agreements around the world. And there has been a great deal of progress. We are particularly interested in an Open Sky Agreement such as the EU and the U.S. have tentatively agreed upon, which would allow us to significantly expand our operations within the EU, and from the EU to Asia.

The NPRM that the Department of Transportation has proposed, listening to the conversation today, has been stood on its head. In actual fact, the chart that Senator Lautenberg put up there, with the blue and the red circles are not the things that the carrier—the minority investor, the foreign investor, can control; in fact, they are the things that they cannot participate in. The facts of the matter are that 75 percent of the U.S. air carrier must be owned by American interests and under the actual control. And that means schedules and so forth.

The protection that's afforded by this NPRM was a direct descendant of many of the investments made particularly by European carriers which ended up very badly for those carriers. You will hear from Continental Airlines today about their opposition to this NPRM. In fact, Scandinavian Airlines System made a significant investment in Continental in 1988 and 1990, I think, and lost that investment when it went bankrupt. KLM made a substantial investment in Northwest. You will hear from Captain Woerth about that. It was not the investment in Northwest by KLM that allowed them to coordinate their schedules and to allow KLM to do flying which should have been done by American interests. It was the antitrust immunity in the alliance that was provided by the Department of Transportation under the current bilateral system. And in Memphis, for instance, the flight was—KLM flies our flight to Amsterdam off the Northwest complex there as a result of that collaboration, which, in any other industry, would be illegal.

So, we feel that this NPRM, which codifies what foreign interests can and can't do, and gives them some protection, as opposed to the 1940 regulations that Secretary Shane mentioned, is a very good thing, and, if it leads to Open Skies with Europe, that's good for American aviation interests, it's good for American employees, it's certainly good for FedEx.

And, finally, Mr. Chairman, I would note to you that the term "actual control" really comes from our industry, when foreign inter-

ests bought into one of our competitors and we and United Parcel Service vehemently objected to these foreign interests exerting what we felt was *de facto* control, even though there was a *de jure* majority American shareholder that owned 75 percent. So, there's a long history to this bilateral system. There's a long history to this negotiation. And we would urge the approval of the Congress of this NPRM and the negotiation of a new Open Skies Agreement between the United States and the EU.

[The prepared statement of Mr. Smith follows:]

PREPARED STATEMENT OF FREDERICK W. SMITH, CHAIRMAN, PRESIDENT, AND CEO, FEDEX CORPORATION

Chairman Stevens, Ranking Member Rockefeller and members of this Subcommittee, I appreciate the opportunity to testify today on this important matter. Aviation liberalization has been critical to our company, FedEx, since it was founded in 1973. Opening up the air transport market has allowed U.S. air carriers to innovate and develop new products such as our overnight express service. The DOT's proposed rule will move U.S. aviation policy in a positive direction, for shippers, passengers, and our national economy.

Today, I would like to briefly address the merits of the DOT's proposed rule. Then, I would like to expound on the benefits to all Americans of trade liberalization in general, and aviation liberalization in particular.

I. Department of Transportation's Proposed Rule

The DOT has crafted a Rule with at least four salient and attractive benefits. First, the DOT's proposal is straightforward. It would allow foreign investors to take part in certain commercial management tasks at a U.S. airline and thereby protect their investment, without fear that DOT will decide that they are in "actual control" of that airline. Since the existing statute limits foreigners to a minority equity position in a U.S. airline, overall "actual control" will at all times remain in the hands of U.S. citizens.

Second, the DOT's proposal is a modest one; it does not change current law. Instead, DOT is encouraging foreign investment by adding more certainty to what "actual control" means. This interpretation is the normal exercise of discretion that administrative agencies such as the DOT have. The NPRM provides for areas in which foreign participation will be allowed—the commercial arena—and reserves others for U.S. citizens—matters of safety and security. By bifurcating the management responsibilities—a technique used in other security-sensitive businesses—the proposal would work well for U.S. carriers, U.S. airline employees and management, as well as the foreign investment that it seeks to encourage, without harming U.S. governmental interests.

Third, the DOT's proposal encourages foreign direct investment in U.S. airlines. Direct investment benefits our economy in several ways. By increasing the number of bidders for U.S. businesses, foreign investment increases the prices the U.S. owners can hope to realize. New investors often introduce efficiencies or new technologies. A foreign investor can enhance competition, leading to better service at lower prices. Finally, since a foreign investor will invest only if it thinks it can make a profit, the investment should make jobs more secure and increase tax revenues.

Finally, adoption of the Rule protects U.S. companies by assuring "equal opportunities" between trading partners. Only those investors from like-minded countries can claim its benefits. By requiring reciprocal investment opportunities, it will assure that U.S. investors will be able to participate in other countries' air markets. This is good news for our airlines that want to spread their business models beyond our domestic market. Further, the rule offers a new incentive for countries to enter into Open Skies agreements—supporting what is, without a doubt, the most successful policy initiative of the DOT in the last quarter century. For airlines like FedEx, which need the foreign access provided by Open Skies to participate in new markets, this is the best news. How these incentives work are laid out in our DOT comments, which I ask be incorporated into the record as part of my written testimony.

II. Benefits of Trade and Aviation Market Liberalization

While the proposed DOT rule is clearly beneficial to the United State, I believe the central question to this debate is more fundamental. Does removing trade barriers and liberalizing aviation markets benefit the United States? The short answer to this question is "yes." Trade liberalization is beneficial, necessary and rational

-America should be enhancing opportunities for foreign investment and foreign commercial participation in a critical infrastructure industry such as aviation. Several important points must be made in support of aviation liberalization.

International air transportation is now a global industry, not merely a bilateral one. Connecting the U.S. to foreign points is an important function, but as services expand, carriers can make such connections more efficient and effective if they can develop networks that include third country market opportunities. FedEx is among the best at building networks—our international hub and spoke air network is without peer—but we could not have accomplished this without the system of aviation agreements spawned by the Open Skies policy of the DOT. Today, the DOT is trying to move beyond these bilateral agreements to multilateral ones, which can create even more efficient networking opportunities.

The multilateral agreement with the most immediate possibility and enormous potential impact is the U.S.-EU agreement. Under the provisions of this new agreement, FedEx would be able to continue building its network with the completion of a system of intra-European Fifth Freedom rights—the rights to operate in international markets beyond our shores—and we very much support that proposed agreement. With this proposed agreement, market barriers such as the antiquated Bermuda II agreement would end. Our services would be made more efficient and our network stronger, which would benefit both our U.S. and our global customers. We would expand our airline's reach, creating more jobs for our pilots on the much-desired international flying legs. The negotiated terms of this agreement are available at this time, but this window will not remain open indefinitely. To extend what has already been a long and difficult negotiation puts this carefully crafted agreement in jeopardy.

However, while FedEx is seeking access to international markets beyond the United States, foreign airlines, competitors, and investors are eyeing the U.S. market. Some may want to link their international network more closely with a U.S. carrier, while others see possibility in bringing new business models, which would add new dimensions to the U.S. marketplace. Market liberalization will benefit the U.S. consumer. Domestic deregulation has been, at times, difficult and controversial, but the biggest beneficiary has been the U.S. consumer. Expanding market participation internationally, in the measured, controlled manner DOT has proposed, can only improve the services available to U.S. shippers and travelers.

No discussion of trade liberalization is complete until we address the impact that market liberalization has on American jobs. Despite what you hear, trade liberalization benefits U.S. workers. We've heard a lot about the risk of job migration offshore—in fact, I have no doubt that you will hear more about it as this debate continues. But throwing up trade barriers and stopping the internationalization of aviation does not create jobs, it merely fences them off inefficiently. Ultimately, healthy, competitive companies create jobs, regardless of their homeland. We need to provide U.S. businesses with the best possible tools to reach new markets, to obtain the best capital and management, and thus to create the very best jobs right here in our home market.

Some opponents have claimed that liberalizing aviation markets would undercut the U.S. CRAF program. The DOD is not saying that. The DOT supplemental notice reflects that the DOD has reviewed the proposal and agrees with it. As long-time participants, we believe that the CRAF program, an important part of U.S. defense logistics, will not be harmed by this proposal. CRAF participation today provides profitable government contracting incentives for U.S. companies, and we believe that foreign investors would support pursuing those profitable opportunities as well.

Globalization cannot be one way. If the U.S. wants to expand opportunities for its businesses abroad, it must provide opportunities for others here at home. America has benefited tremendously from foreign investment. There is nothing novel or theoretical about the proposition that greater foreign investment can benefit U.S. airlines and their U.S. employees. It is an incontestable fact that past foreign investment in U.S. airlines has saved and created U.S. jobs. British Airways' investment in US Airways, Scandinavian Airlines' investment in Continental and KLM Royal Dutch Airways' investment in Northwest all protected U.S. jobs, and none of these investments spurred an offshore exodus of U.S. jobs. In fact, the exact opposite was true—they stimulated new American jobs.

At the same time, U.S. companies have become world players through reciprocal foreign investment. FedEx has invested in major facilities abroad to open up new markets to U.S. shippers and exporters, including our hub in Paris and the planned hub in Guangzhou, China. With these hubs, we are able to offer U.S. businesses more efficient worldwide express services, creating American jobs as we grow. So, foreign investment can be good for U.S. businesses, workers, and consumers. But it is, and must be, a two-way street.

Congress has expressed its concern about the security aspects of foreign investment, and I agree that is important. Clearly, we must manage the security risks carefully, but we must be careful not to block foreign investment altogether. For aviation, the United States must continue to require strict compliance with U.S. aviation safety and security regulations. The DOT's proposal as supplemented, with its safeguards for U.S.-citizen control over functions such as safety and security, is a wise and measured way to address that concern.

I hear some argue that this is the wrong time to be promoting trade liberalization, and the concept of open markets is the wrong message to send to the rest of the world. They say the United States should be protecting, not liberalizing, access to world markets. I disagree: this is exactly the right time and the right message for the future of our industry. To reject this opportunity would be to send a message that the U.S. is no longer interested in new international opportunities for its airline industry, at a time when its future—and the future of the jobs its supports—hinge on expanding these opportunities.

Look closely at those opponents of liberalizing aviation markets. While they claim important government regulatory concerns motivate their arguments, instead their primary concerns are narrow, protectionist interests. Their interests have almost nothing to do with concerns over "ownership and control"; in most cases, they simply oppose the U.S.-EU bilateral agreement, which the proposal would advance. Some airlines want to slow down competitive forces, hoping to retain their privileged market positions, and to benefit from the indirect government subsidies that protectionism provides. Others have been vitriolic, raising false concerns ranging from cockpit security to a mass migration of jobs offshore. These arguments are not new, and they hold little merit under close scrutiny.

III. Conclusion

The DOT proposal is another step in a long history of opening up opportunities in aviation, in creating value and jobs for our economy, and in expanding a dynamic, growing global marketplace. Global trade—both in goods and in services—presents important opportunities for U.S. business and U.S. workers. The DOT proposal encourages global trade, starting with the creation of new opportunities for more effective foreign participation in U.S. carriers. It opens the door for investment by our citizens in aviation abroad. Alone, the proposal is good for U.S. airlines, workers, and consumers. Combined with a U.S.-EU Open Skies Agreement, it could be a tremendous boost for the U.S. aviation industry. We at FedEx support the DOT proposal and hope that this committee will do the same.

On behalf of the 260,000 employees and contractors of FedEx Corporation, and especially those at FedEx Express, our express transportation company, I want to thank you for inviting me here today.

Senator BURNS. Mr. Jeffrey Smisek, of Continental Airlines?

STATEMENT OF JEFFREY SMISEK, PRESIDENT, CONTINENTAL AIRLINES, INC.

Mr. SMISEK. Thank you.

Good afternoon. My name is Jeff Smisek, and I'm the President of Continental Airlines. On behalf of my 42,000 co-workers, I appreciate the opportunity to express our opposition to the Department of Transportation's supplemental notice of proposed rulemaking on foreign ownership and control.

We, at Continental, support increasing U.S. airlines' access to foreign capital; however, we continue to oppose the Department's proposed rulemaking, for three reasons. First, it is unlawful. Second, it is unworkable. And, third, it will not result in increased access to foreign capital.

In their Alice in Wonderland world, the Department of Transportation is trying to interpret a requirement that actual control of U.S. carriers must be in the hands of U.S. citizens to mean that actual control of U.S. air carriers may be in the hands of foreign citizens. Both the original proposal and now the supplemental proposal would allow foreign citizens to control virtually every com-

mercial aspect of a U.S. airline. The DOT says it is addressing concerns raised by its initial proposal by still allowing foreign control of U.S. airlines, but requiring that foreign control be revocable by a majority of the board of directors or shareholders. So, the only significant difference between the new and the old proposals is that the DOT asserts that it will rely on U.S. boards of directors and shareholders to protect U.S. interests. Never mind that these private citizens have no responsibility and no incentive whatsoever to protect national interests rather than shareholder interests. Never mind that boards of directors have a fiduciary duty to protect shareholder interests, not national interests.

Since the DOT doesn't explain how the revocation might work, and doesn't even bother to include it in the actual proposal itself, let's think about how it might work in a real-world example.

Let's say Senator Inouye—think of him as a foreign investor that DOT wants to attract—would like to invest in the Commerce Committee, but only if he can share it. So, he offers the Committee, through Senator Stevens, a billion dollars, as long as Senator Inouye gets to control or chair the Committee to make sure his investment's protected. Senator Stevens and the other Republicans—think of them as the board of directors—agree, because, without the billion dollar foreign investment from Senator Inouye, the Committee will be merged with the Governmental Affairs Committee, and everyone would lose their seniority. Clearly not acceptable.

So, the Republicans say, "Sure, we'll take your billion dollars, but we must retain the right to revoke your Chairmanship anytime we want to." Does Senator Inouye say, "Fine, you can revoke my right to control the Committee and still keep my billion dollars?" Of course not. Senator Inouye will say, "OK, but if you ever revoke my control, you have to pay me back my billion dollars, plus the amount I would have made on it, had I invested it somewhere else." Let's say a $1.2 billion, total.

Now, Senator Stevens and the Republicans have the theoretical right to take the chair back, but only if they can cough up $1.2 billion in cash. But if they had $1.2 billion in cash sitting around, they wouldn't have turned over control in the first place. So, the probability that Republicans are ever actually going to revoke Senator Inouye's right to chair the Commerce Committee is zero. "But wait," says the DOT, "maybe the voters"—think of them as the Commerce Committee shareholders—"will throw out their Republican Senator-Directors, because they turn control over to the Democrats." Well, as you know, voters, like shareholders, have nothing to do with the day-to-day operations of Senate Committees, and no real way to change them, except to theoretically throw out all the Senators on the Committee. But the probability that the voters in multiple states are going to band together and organize a recall of all the Republicans on the Commerce Committee is zero.

Now, you may think this example is laughable, but this absurd construct is exactly what the DOT relies on to assure the Congress that U.S. citizens will maintain control of U.S. airlines, as required by law.

The probability that the board of directors or shareholders of a U.S. airline, having bargained away control to a foreign investor in return for a substantial cash infusion, will turn around and revoke

that control, when it would be contrary to the very shareholder interest that the board has a fiduciary duty to protect, is precisely equal to the probability of being eaten by a shark while being struck by lightning.

The truth of the matter is, the proposed rule doesn't offer any protection whatsoever from foreign domination or control, except for a limited, naive, and impractically crafted attempt of DOT to carve out safety, security, military airlift, and organization documents. But DOT says the EU treaty is so important that we can't wait for Congress to change the law, and, therefore, DOT must step in, seize power, and immediately give foreign investors the right to control U.S. airlines. At the same time, DOT says to Congress, "Don't worry, foreign investors won't really have the right to control U.S. airlines, because the U.S. directors or shareholders will be able to revoke that control anytime they want to." But the rule can't, and doesn't, do both things.

The DOT is trying to convince both sides of the Atlantic that everyone gets exactly what they want. DOT is promising foreign investors that they will have control over U.S. airlines, because, otherwise, the EU would refuse to sign the Open Skies Agreement. And DOT is promising Congress that foreigners won't have control of U.S. airlines. So, the proposed rule will create years of substantial uncertainty for both foreign and domestic investors as the legal and practical consequences are sorted out and, I assure you, litigated.

Now, I've got a research report from JPMorgan that just came out. JPMorgan said in this research report that, "We would now advise—this is based on the SNPRM—that, We would now advise European airlines not to invest at all under conditions of revocable authority currently proposed." I'd like to submit the JPMorgan report——

Senator BURNS. Without objection.

[The information previously referred to follows:]

JPMorgan—European Equity Research, May 5, 2006

GOODBYE OPEN SKIES—A U.S.-EU AVIATION DEAL FOUNDERS AGAIN

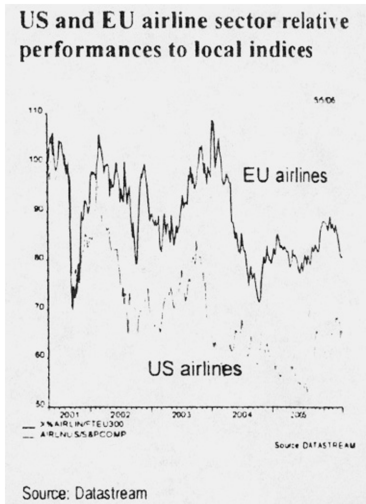
The U.S. DOT has put a new rule out for comment covering foreign ownership and control of U.S. airlines, responding to growing domestic protectionist sentiment sparked both by the previous proposed rule and by the Dubai/P&O transaction.

We had not expected the DOT to try to modify its contentious proposed rule—we thought that the issue would remain parked in the long grass in the hope that protectionism might die down.

The proposed new rule shifts the balance of the proposal back in a U.S. direction, trying to appease the domestic opposition. The technique added to the previous proposed rule is to permit controlling U.S. shareholders to revoke unilaterally their delegation of authority to a non-U.S. airline/investor.

While this may satisfy some U.S. objectors, we believe that it fundamentally undermines the previous liberalisation proposed.

We had difficulty before in creating plausible scenarios where European airlines might invest significant sums in U.S. airlines under the last proposed rule.



We would now advise European airlines not to invest at all under the conditions of revokable authority currently proposed, since their original basis for investment could be unilaterally withdrawn, leaving them with a material minority investment and no control. We have been there before with BA/USAir and KLM/Northwest.

Consequently, we fail to see how this new proposal permits European airlines to do anything new in terms of investing in U.S. airlines, and we would expect the EC negotiators to tell their U.S. counterparts that this proposed rule does not conform with their previously-negotiated tentative deal.

Open Skies between the U.S. and the EU is now, in our view, less likely than it was earlier this year (we said "too hard to call" in January). This has particular implications for London Heathrow, where the competitive landscape will not change materially until Open Skies arrives. We think that has reverted to "if", not "when".

The DOT's New Proposed Rule

The DOT has put a modified rule out for comment on the subject of foreign ownership of U.S. airlines. The tentative agreement between the U.S. and the EU last year on an Open Skies deal requires change in U.S. rules such that EU airlines could take greater control if they invest material sums in U.S. carriers. (EU = European Union, *i.e.* the block of 25 countries. EC = the Commission which is the negotiator.)

The initial proposed rule which we wrote on in January this year came close to satisfying the EU's objective of permitting EU airlines effective control over a U.S. airline's commercial decisions in the event of a transaction. The DOT needed U.S. persons to control the company's legal documents, and its relations with FAA, DHS, TSA and CRAF (safety, security and military airlift), but a non-U.S. investor could "dictate" commercial policy and decisions. All provided that U.S. persons owned 75 percent or more of the voting stock, and 67 percent+ of the management positions.

Under the Previous Proposal, a Viable Transaction Could Be Drawn

Under that proposed rule, it was possible to envisage a transaction which made commercial sense to contracting parties, even if there would be vocal opposition from, for example, U.S. airline labour unions. One could see how an EU airline might invest $1 bn-plus in a (bankrupt?) U.S. major for a 25 percent equity stake, but accompanied by a contract with the 75 percent U.S. owners under which the EU airline could manage the U.S. airline (its $1 bn+ investment) in all areas except those listed above (safety, security and military airlift). The EU airline would be able to manage its investment's route network, commercial strategy and labour relations under that scenario.

In January, We Put the Probability of U.S./EU Open Skies as the Best for 20 Years

Although that rule did not attempt to change the U.S. 75 percent voting majority ownership rule, the result of that rule was that an EU airline could effectively buy control of most of a U.S. carrier's business. Consequently, the rule met the spirit of the tentative open skies deal between the U.S. and the EU, and in January 2006

(with significant hurdles still to jump) we put the probability of an Open Skies deal being too close to call (*i.e.,* 50/50), the best probability ever in our near-20 years following this specific issue.

Growing Protectionism Meant That Proposal Foundered

However, the January proposed rule coincided, unfortunately, with a rising tide of global protectionism. In the U.S., there were two specific currents which caused that proposed rule to lose relevance, First, the Dubai Ports acquisition of P&O, and the consequent potential ownership of U.S. port facilities by that acquiror, caused a protectionist wave in the media, and this issue is not yet finished. Second, Continental Airlines caused a backlash against the proposed rule among politicians, and publicly said that it would take the DOT to court for acting beyond its jurisdiction.

In the circumstances, we expected DOT to keep its head below the parapet, and simply wait (hope?) for the protectionist wave to die down before trying something again. The DOT has not done that—it has reissued a new rule for comment, bending in the direction of its domestic opponents. However, by shifting ground, we believe that the tentative agreement with the EU will now have been lost.

We see two key changes in the new proposed rule. The first is a relatively minor one—U.S. persons' control of matters relating to security, safety and military airlift is widened. The second is, in our view, a deep, deep cut into the heart of the last-proposed balance between U.S. and EU interests in control of a U.S. airline.

The New Rule Permits Management Authority To Be Unilaterally Revoked

The DOT's new rule permits the U.S. 75 percent voting owners or the directors (minimum 67 percent U.S. persons) to unilaterally revoke the authority that they have given which permitted a non-U.S. person (*i.e.,* an EU airline) to control the U.S. airline's commercial activities. This is an important strengthening of the U.S. side of the balance—in our view, too much.

Trying again to create a hypothetical transaction under this new scenario appears to us to fail—one side's position is simply not commercial. An EU airline, offering to put $1 bn+ equity into a (bankrupt?) U.S. carrier, would now contract with the 75 percent U.S. voting interests to manage the airline's commercial activities. However, even if the contract did not say this, the U.S. shareholders could simply revoke the contract at some future point, if, for example, they did not like what the EU airline was proposing to do with its quasi-acquisition. All fine from the U.S. protectionist side—$1 bn+ of foreign equity, 75 percent U.S. voting control and a veto to reverse the contract that was the core of the $1 bn injection in the first place.

The U.S. Shareholders and/or Directors Would Have That Power

However, from the EU investing airline, the proposed new rule is fundamentally different to the last because of the power of revocation given to the U.S. 75 percent voting equity owners. What management would invest under such circumstances? The previous rule had many queries against it from EU airlines, with the longevity of the new rule being a key one—what the DOT set, the DOT could take away. However, this new rule *gives the other shareholders* (and/or the directors) in the investment the veto power to unilaterally take away the power that they gave in return for a $1bn+ investment.

We Would Not Be Happy To See an EU Airline Invest its Money on These Terms

We would be less than happy with an EU airline who invested its shareholders' money into such an ill-protected investment, We look back at BA/USAir and KLM/Northwest for real examples where an initial (welcomed) equity stake ended up in rancour/rancor and the courts. If revocation of some authority previously granted had been available to the U.S. shareholders in either case, it would, we believe, have been used,

We Believe That This New Proposal Moves Us Away From Open Skies

By making the delegation of authority to manage revocable at will on the U.S. side, we believe that this new proposed rule does not change materially the foreign ownership and control rules for U.S. airlines from their current state today. We cannot see how the EC negotiators can conclude differently, and would be surprised if this proposed rule leads now to U.S./EU open skies.

We believe that the probability of such an open skies deal has now slumped back down to a low level as global protectionism gains ground.

Mr. SMISEK. The truth of the matter is that the DOT has developed this tortured and poorly constructed rule as part of their blind pursuit of a so-called Open Skies Agreement with the EU which is

anything but open. The Agreement that U.S. has negotiated gives the U.S. combination airlines, like Continental, little except the meaningless right to fly to London Heathrow Airport without being permitted to land there. If we started doing that, we'd run out of airplanes pretty fast, because we'd send them over, and they wouldn't come back. Commercially-competitive slots and facilities are simply not available at London Heathrow, which is the most important business market in Europe.

We, at Continental, believe that the DOT should go back to the drawing board on its proposed rule and on the EU treaty. As to foreign ownership, DOT should stop trying to take the law into its own hands and should instead persuade the Congress to change the law in a way that opens additional access to capital markets while meeting the national needs. As to the EU deal, they should go back to the bargaining table and insist on fair access to slots and facilities so U.S. carriers, like Continental, will be able to compete, from day one, on a level playing field.

I want to thank you for this opportunity to speak before you, and I'd be happy to answer your questions.

[The prepared statement of Mr. Smisek follows:]

PREPARED STATEMENT OF JEFFERY SMISEK, PRESIDENT, CONTINENTAL AIRLINES, INC.

Good afternoon. My name is Jeff Smisek, and I am the President of Continental Airlines. On behalf of my 42,000 co-workers, I appreciate the opportunity to express our opposition to the Department of Transportation's supplemental notice of proposed rulemaking on foreign control.

Continental supports increasing U.S. airlines' access to foreign capital, and Continental supported legislation sent to Congress by this Administration to nearly double the level of permissible foreign investment in U.S. airlines. If Congress takes the leadership, access to foreign capital for U.S. airlines can be enhanced lawfully in accordance with clear and practical standards. In sharp contrast, the Department of Transportation's Supplemental Notice of Proposed Rulemaking and the original Notice of Proposed Rulemaking before it are unlawful under current statutory standards, totally unworkable in the real world of airline operations and likely to inhibit access to foreign capital by U.S. airlines. Although the Supplemental Notice of Proposed Rulemaking makes some changes in the Department of Transportation's description of what it intends to do, the proposed policy itself is virtually unchanged and is no more legal, workable or likely to encourage investment than the original proposal was. I have attached for your consideration the Continental press releases responding to issuance of these proposals.

As Continental's comments on the Department of Transportation's Notice of Proposed Rulemaking (copy attached)* amply demonstrated, the Department's decision that "actual control" by U.S. citizens permits "actual control" by foreign citizens over all commercial aspects of a U.S. airline is unlawful. Although the Supplemental Notice of Proposed Rulemaking relies on the Department of Transportation's discretion to interpret the aviation statutes, in an analogous situation the D.C. Circuit said this in reversing a decision of the Securities and Exchange Commission interpreting the Public Utility Holding Company Act (PUHCA):

> The Commission may well be right that PUHCA's region requirement is outdated. . . . In view of the statute's plain language, however, only Congress can make that decision. . . . In the meantime, the Commission may not interpret the phrase "single area or region" so flexibly as to read it out of the Act.

National Rural Elec. Co-op. Ass'n v. *S.E.C.,* 276 F.3d 609, 618 (D.C. Cir. 2002)

Clearly, "actual control" by U.S. citizens means precisely what it says: actual control of an entire airline all the time. The statutory definition does not say "actual control sometimes," or "actual control of parts of an airline's operations," or "actual control only of areas already regulated by the government" or "actual control when foreign owners are citizens of some countries but not others." Neither the Notice of

*The information referred to has been retained in Committee files.

Proposed Rulemaking nor the Supplemental Notice of Proposed Rulemaking provides a shred of statutory analysis to suggest that the phrase "actual control" of U.S. airlines by U.S. citizens was intended to mean control of only certain aspects of an airline's operations, control only at certain times or control delegated but subject to revocation. Moreover, requiring that 75 percent of shareholders, the President and two-thirds of Board members and managing officers be U.S. citizens does not necessarily mean that U.S. citizens control an airline. If these requirements alone always satisfied the control test, there would have been no need to impose the additional requirement that the airline be under the "actual control" of U.S. citizens.

Congress expressed its view that U.S. airlines must be entirely controlled by U.S. citizens when it added the "actual control" requirement to the aviation statutes in 2003, and over the last 6 months it has again expressed its view that "actual control" of U.S. airlines must be vested in U.S. citizens at all times. Beginning with a November 18 letter signed by 85 Congressional Representatives saying that the Department's proposal is "contrary to recent Congressional mandates," including the requirement that U.S. interests "control economic and competitive decisions of the airlines, as well as safety and security decisions" and that the "Department has overstepped its authority in this proposal with its revised interpretation of 'actual control,'" Congress has repeatedly expressed serious concerns about the Department's unlawful proposal. With nearly 190 co-sponsors, H.R. 4542 reflects these Congressional concerns, notes that the Department's proposal is "contrary to the plain language" of the aviation statutes, prohibits the Department from issuing its decision for a period of 1 year and requires a report from the Department regarding the impact of its proposal on U.S. airlines and the aviation industry and how the Department would implement its proposed policy. Similarly, the House Appropriations Committee unanimously adopted report language saying "the Committee believes that the U.S. aviation industry is part of our critical infrastructure as are the ports," and "it is critical that any final rule regarding foreign control of U.S. airlines not only comply with current laws regarding foreign ownership, but also comply with statutes recently passed by the Congress which require that all U.S. airlines be under the 'actual control' of U.S. citizens" and therefore "directs the Secretary of Transportation to refrain from issuing a final rule for 120 days" because the "Committee is seriously concerned about the promulgation of any rule which would allow any minority foreign investor to exercise control or decisionmaking authority over any aspect of a U.S. carrier operation." More recently, the Senate Appropriations Subcommittee on Transportation, Housing and Urban Development and Related Agencies adopted legislation that would prohibit the Department from using any of its funds to issue or implement a decision in this proceeding or to make any fitness determinations based on new standards.

Other U.S. and foreign airlines also recognize the uncertainty resulting from the Department's proposal and the need for Congressional action. As US Airways said, the Department's proposal "could cause uncertainty and possible harm to the U.S. airline industry" (US Airways comments at 1), and Delta said, "Investor concerns about . . . the extent to which a statutory amendment may be required to provide legal certainty" and the "scant guidance" in the Department's proposal on implementation of the control provisions separating "commercial" operations from security and safety areas with which they are inextricably intertwined would undermine the Department's objectives. (Delta Comments at 8, 11) Alaska also said that Congress, not the Department, should address any changes to the control standards. (Alaska Comments at 1–2) As Virgin Atlantic put it, "the NPRM raises as many questions as it answers, creating an unacceptably high level of uncertainty for would-be investors" (Virgin Atlantic Comments at 1) Similarly, British Airways said the Department's "objectives would best be achieved through amendment or elimination of the existing statutory restrictions" and recognized that the Department's proposal would be "subject to potential reversal or modification by Congress, the Federal Courts or the Department itself." (British Airways comments at 1)

In the wake of these extraordinary public and Congressional concerns about the control of critical transportation facilities by foreign nationals and pending legislation, the Department should suspend its pending rulemaking proposal and instead seek legislation to make any potential changes to the definition of "actual control" in the aviation statutes.

Indeed, the very proceeding in which the Department now plans to abandon the unequivocal decades-long interpretation of the actual control requirements was begun because of Congressional concern about the lack of clear, published standards for determining that actual control of airlines was held by U.S. citizens and the lack of transparency in the Department of Transportation's procedures for reviewing citizenship determinations. Congress had even been forced to pass legislation requiring

the Department of Transportation to institute a formal proceeding to investigate the citizenship of a cargo airline after years of complaints by Federal Express and United Parcel Service that the cargo airline was controlled by foreign interests. Despite these repeated Congressional criticisms, however, the Department of Transportation is proposing to publish only the most skeletal policy statement and to continue making its foreign control determinations behind closed doors in negotiations with foreign investors and the airlines they seek to control.

Although the Department of Transportation has described its original and supplemental proposals as a "clarification" of its interpretation in the U.S., it has told foreigners that the proposals represent a "profound change" to the actual control standards. The proposals clearly represent a profound change since they are diametrically opposed to the standards historically applied and the actual words of the statute. They are anything but a "clarification." They would be better described as a "reversal" and an "obfuscation" than a "clarification."

The entire text of the proposed Department of Transportation policy is:

> (b) *Policy*. In cases where there is significant involvement in investment by non-U.S. citizens and either where their home country does not deny citizens of the United States reciprocal access to investment in that country's carriers and does not deny U.S. air carriers full and fair access to its air services market, as evidenced by an Open Skies Agreement, or where it is otherwise appropriate to ensure consistency with U.S. international legal obligations, the Department will consider the following when determining whether U.S. citizens are in "actual control" of the air carrier:
>
> (1) All organizational documentation, including such documents as charter of incorporation, certificate of incorporation, by-laws, membership agreements, stockholder agreements, and other documents of similar nature. The documents will be reviewed to determine whether U.S. citizens have and will in fact retain actual control of the air carrier through such documents.
>
> (2) The air carrier's operational plans or actual operations to determine whether U.S. citizens have actual control with respect to:
>
> (i) Decisions whether to make and/or continue Civil Reserve Air Fleet (CRAF) or other national defense airlift commitments, and, once made, the implementation of such commitments with the Department of Defense;
>
> (ii) Air carrier policies and implementation with respect to aviation security, including the transportation security requirements specified by the Transportation Security Administration; and
>
> (iii) Air carrier policies and implementation with respect to aviation safety, including the requirements specified by the Federal Aviation Administration.

Clearly, these skeletal provisions raise more questions than answers, and not one of the "safeguards," such as revocability, cited by the supplemental notice's rationale is even mentioned in the policy itself. What is "significant involvement in investment" by non-U.S. citizens? What does "reciprocal access to investment" mean? In what situations would it be "otherwise appropriate to ensure consistency with U.S. international legal obligations" to permit foreign control by citizens of a country which neither permits reciprocal investment nor has an open-skies agreement with the U.S.? Although the proposed policy says the carrier's "organizational documentation" will be reviewed "to determine whether U.S. citizens have and will in fact retain actual control of the air carrier through such documents," the Department's own statements make perfectly clear that the Department has no intention whatever of insuring that the air carrier is actually controlled by U.S. citizens. How could the Department of Transportation actually "consider" an "air carrier's operational plans or actual operations" to determine whether U.S. citizens have actual control with respect to decisions on CRAF or other national defense commitments and implementation of those commitments, policies and implementation "with respect to aviation security" and "aviation safety?" The standards that would apply to any of these decisions are totally absent from the proposed policy.

Just as importantly, no one will ever know what standards are being applied, or have been applied, to citizenship determinations since the decisions will be reached behind closed doors in negotiations between foreign investors, the airlines they are investing in and Department of Transportation officials who are not experts in corporate governance or airline operations.

Although the Supplemental Notice of Proposed Rulemaking purports to broaden the scope of U.S.-citizen control required for safety, security and national defense decisions, it fails to recognize the fundamental fact that corporate control of such decisions cannot be bifurcated. Clearly, every decision that affects budgets, per-

sonnel, promotions, wage rates, financing and investment affects safety, security and national defense. If indeed "all critical elements of a carrier's decision-making that could impact safety, security and national defense airlift" must be made by U.S. citizens who are not beholden to foreign investors, then foreign citizens may not control aircraft acquisition, routes, financing, budgets, personnel or any other significant aspect of the U.S. airline's management or operations. That may be what the Department of Transportation is telling its U.S. audience, but you can bet assurances will be given Europeans that such constraints will not be applied.

Although the Department of Transportation's witness in House hearings testified that foreign citizens could contract with U.S. airlines to transfer control for all commercial aspects of an airline's operation to foreign citizens, the Supplemental Notice of Proposed Rulemaking raises even more questions about how control would be monitored and distributed. Although the supplemental proposal would require U.S. citizens to "control the carrier's organizational documents," it would not prevent those citizens from amending those organizational documents to turn control over to foreign citizens to facilitate the "greater alliance integration" and consolidation in the airline industry that the Department of Transportation supports.

Although super-majority, "golden share" and other control provisions are normally bargained for and exchanged for significant financial benefits, the Supplemental Notice of Proposed Rulemaking says that the Board or voting shareholders must retain the power to revoke delegations of managerial responsibilities to foreign investors and that the ability to revoke the delegation could not be conditioned on terms that would make revocation "impracticable." This requirement appears nowhere in the proposed policy, and constant monitoring by the Department of Transportation to ensure that agreements between the parties have not made revocation "impracticable" would require hiring airline, financial, legal and corporate governance experts. Would revocation be "impracticable" if the result would be termination of a codeshare or alliance with a foreign airline partner? Would refusing to make further foreign investments needed by the U.S. airline in the event of revocation render revocation "impracticable?" Would a mandatory redemption of equity securities or repayment of indebtedness render revocation "impracticable?" Once a U.S. airline had terminated its transatlantic flights in favor of its foreign partner's flights, would revocation be "impracticable" because the U.S. airline would lose access to transatlantic traffic?

The Department's proposal to bifurcate a carrier's management and operations into foreign-controlled and U.S.-controlled segments is both naïve and totally unworkable. As Continental and other airlines have explained, safety, security and defense commitments are integral to an airline's entire operations and cannot be separated from "commercial" decisions. If, as the supplemental notice of proposed rulemaking indicates, foreign investors could not hire and fire corporate officers; all managing officers responsible for safety, security and national defense must have only U.S.-citizen supervision; and budgets and compensation for these areas must be determined only by U.S. citizens who may not be appointed by or otherwise beholden to" foreign interests, then the scope of delegable foreign control would be extremely narrow since any significant financial, fleet, resource allocation or integrated budget could not be subject to foreign influence. Given the Department of Transportation's objective of offering foreign investors effective control to cement their alliances with U.S. airlines and protect their investments, however, it seems unlikely that the Department of Transportation would take the steps necessary to prevent foreign influence over these significant resource allocation decisions.

Beyond super-majority provisions that require concurrence for bankruptcy or dissolution, the Department says it cannot define what kind of super-majority provisions would violate the requirement that "actual control" remain with U.S. citizens, providing no discernible standards by which to test proposed transactions and leaving all such decisions to the obscurity of private, closed door meetings between the Department of Transportation and foreign investors. Although the Department of Transportation says it would approve of "standard provisions obtained by minority shareholders," it is unable to name any such provisions except for those related to bankruptcy or dissolution.

Although the Department's original proposal indicated that foreign investors could control fleet decisions, the Supplemental Notice of Proposed Rulemaking says that a "carrier could not allow foreign investors to make decisions that would make participation in or other national defense airlift operations impossible as a practical matter," in direct contradiction of advice given to European negotiators by the Department of Transportation's Under Secretary that foreign investors could control the "commercial decision" whether to participate in CRAF or not as well as fleet decisions that would eliminate all CRAF-eligible aircraft from the U.S. airline's fleet. Now, the Supplemental Notice of Proposed Rulemaking says that it "would likely

investigate" if a U.S. carrier's ability to contribute to CRAF or other national defense airlift operations were precluded by "decisions made or significantly influenced by foreign investors." Apparently this "investigation" would occur after a U.S. carrier had already become unable to contribute to the U.S. airlift. But how would that preserve the ability of our Department of Defense to move the troops? Could the deed be "undone?" Would the Department of Transportation require that planes that have been sold, transferred or otherwise disposed of be brought back to the U.S. carrier's fleet? Even if the Department of Transportation could unwind any transaction or series of transactions that created the problems for the Department of Defense as to military aircraft—could it possibly be done in the real time that the Department of Defense might need to move troops to a conflict in a timely manner? Of course not. Even worse, what is the likelihood that a U.S. airline controlled by a foreign government or an airline owned by a foreign government would volunteer for national defense missions enforcing U.S. policies the foreign government opposes?

Both the original proposal and the supplemental proposal assume that corporate decisions can be separated into distinct compartments and that boards and shareholders can and will undertake the Department's responsibility to ensure that U.S. citizens actually control the airline regardless of the economic interests of the directors and shareholders themselves. As the supplemental notice itself points out, "strategic investors" in U.S. airlines do not invest to maximize shareholder value *per se* but to maximize integration between the strategic investor and the airline being invested in. That integration may well enhance shareholder value, but it could do so at the expense of airline employees and other vital interests of the U.S. airline and its stakeholders. Formation of a new U.S. airline to feed traffic between major U.S. cities and a foreign investor airline's U.S. gateways may well enhance the foreign investor's interests and the U.S. airline's profitability while draining traffic and revenue from U.S. airlines that today provide comprehensive network service including small cities throughout rural America as well as the major cities served by the foreign-controlled airline. The network airline may be forced to terminate services at smaller cities to survive the onslaught of new foreign-controlled airlines on major U.S. routes feeding traffic to international foreign-airline competitors. And a nominally U.S. airline owned or subsidized by a foreign government would create an even greater threat to U.S. owned, operated and controlled airlines.

The ultimate responsibility for directing the affairs of any corporation resides with the board of directors, where one-third of the members could be appointed by the foreign investor. Although the boards meet only four to eight times a year and do not manage day-to-day affairs of a company, they appoint a company's executive officers and exercise their authority by hiring, firing, demoting or promoting senior corporate officers, setting overall corporate policy and monitoring corporate results. Lacking sufficient time, power or information to manage a company, corporate boards rely on a corporation's management for information about what and how a company is doing, and management ties to a foreign investor who may well be the largest single shareholder in the company will clearly influence what management does and what it reports to the board. Under standards recognized by virtually every government agency that has considered "control," it is clear that an investor holding a significant share of voting stock exceeding 10 percent of the total voting shares can possess control: "the power to direct or cause the direction of the management and policies of" a company "whether through the ownership of voting securities, by contract, or otherwise."

The likelihood that individual, disparate smaller shareholders who collectively own a majority of the voting stock would be able to counteract the power of a large, focused minority investor and the company's management would be exceedingly slim. Although shareholders, like creditors and minority investors, may have specific rights to vote on extraordinary matters such as mergers, bankruptcy or dissolution and recapitalizations, their only recourse otherwise is engaging in an extremely difficult, expensive and rarely successful proxy fight to nominate their own slate of directors. Other than the replacement of directors, shareholders have no practical way to affect directly how a corporation operates or to have a voice in a corporation's management. As a practical matter, shareholders have about as much practical ability to affect corporate policies by vote as the U.S. public has to repeal Acts of Congress by amending the Constitution. And those actions happen with about the same frequency—practically never.

As the DOT neither explains how revocation might work nor includes it in the actual proposed rule, let's think about how it might work in a "real world" example. Let's say Senator Inouye would like to invest in the Commerce Committee but only if he can chair it. So, he offers the Committee, through Senator Stevens, $1 billion as long as Senator Inouye gets to "control" or chair the Committee to make sure

his investment is protected. Senator Stevens and enough of the Republicans agree, because without the $1 billion investment, the Committee will be merged with the Government Affairs Committee and everyone would lose their seniority—clearly not acceptable! So, the Republicans say, "we'll take your $1 billion but we need to retain the right to revoke your Chairmanship at any time we want to do so!"

Does Senator Inouye say—fine—the Republicans can revoke my right to chair and still keep the $1 billion? No, of course not! Senator Inouye may say OK—but if you ever revoke my control you have to give me back my $1 billion plus the amount I would have made on it had I invested the money elsewhere—say $1.2 billion total.

Now, Senator Stevens and the Republicans (think of them as the Board of Directors) have the theoretical right to take the Chair back—but only if they can cough up $1.2 billion in cash. But, if they had $1.2 billion sitting around in cash they wouldn't have turned over the Chair in the first place! So the likelihood that the Republicans are actually ever going to be able to revoke Senator Inouye's right to chair the Commerce Committee is zero.

But wait, maybe the voters (the Commerce Committee Shareholders) will throw out their Republican Senator/Directors because they turned over control to the Democrats? Well, as Senators know, voters (like shareholders) have nothing to do with the day to day operations of Senate Committees and no real way to change them except to throw out the Senators on the Committee. So, the likelihood that the voters in multiple states are going to get together and organize a recall is zero.

Senators may think this example is laughable, but this absurd construct is exactly what the DOT relies on to assure the Congress that U.S. citizens will maintain control of U.S. airlines as required by law.

The Department of Transportation claims that control of fundamental, pervasive, interrelated fleet, pricing, marketing, financing, "commercial" and safety, security and defense management and operating decisions can be separated because anti-trust-immunized airlines have apparently been able to avoid colluding on specific full fares on a few specific international routes. While extremely-limited carve-outs may be possible for a few airline fares on a few routes or for such one-time major issues as mergers, bankruptcy/dissolution and recapitalization, separating control of some pervasive operating issues from other pervasive operating issues is no more possible than unscrambling eggs. Since all of an airline's decisions are "commercial" and have effects throughout the organization, separation of control of specific items is impossible. Moreover, this is nowhere more true than in the area of legal and regulatory compliance. Everyone may be in favor of safety and security compliance, but the real issue is what resources, both financial and human, will be devoted to those areas rather than to more commercially-beneficial areas. Time and again, the root cause of a compliance failure is unwillingness to spend the money necessary to create and maintain an effective compliance infrastructure. Although U.S. citizens controlling U.S. airlines are aware of the extraordinary importance of optimizing safety and security, foreign investors may not be. Compliance generates costs, not sales, and a company facing criticism from analysts and falling stock prices as well as marketing or customer service issues may well find that its foreign investors insist on allocating resources to priorities other than safety and security.

Because "control" is a practical test which cannot be measured by share ownership and management numbers, the Civil Aeronautics Board, the Department of Transportation and Congress have all recognized that "actual control" by U.S. citizens must be maintained in addition to the numerical standards in the aviation statutes. In addition to super-majority voting requirements, classes of shares with different voting rights, contractual arrangements in debt, equity or management agreements, voting agreements among shareholders, agreements as to composition of key Board committees and the practical effects of a concentrated holding of up to 25 percent with a widely-dispersed holding of up to 75 percent can readily and effectively hand control of a U.S. airline over to foreign interests.

The current proceedings before the Department of Transportation to reconsider foreign control standards began as an effort to strengthen the standards to ensure U.S. control of U.S. airlines and to make the process more public and transparent. Only when the prospect of a U.S.-EU deal entered the picture did the proposal make a 180 degree turn and become a proposal to permit near total foreign domination and control of U.S. airlines and retain the clandestine procedures previously followed. Disclaimers to the contrary notwithstanding, it is perfectly clear that the Department of Transportation is pursuing its effort to allow foreign control of U.S. airlines to secure a multilateral "open skies" agreement with the European Union. The U.S. already has Open Skies Agreements with The Netherlands, Belgium, Finland, Denmark, Norway, Sweden, Luxembourg, Austria, Switzerland, the Czech Republic, Germany, Romania, Italy, Portugal, Poland, France, Albania, and Bosnia and Herzegovina, and those Agreements permit airlines of those countries to offer serv-

ice between any point in Europe (or the world) and any point in the U.S. as well as permitting all U.S. airlines to offer service between any point in the U.S. and any points in one or more of those countries. Moreover, in other European countries that have not yet signed Open Skies Agreements, U.S. airlines are already offering substantial amounts of services and have been freely able to expand, with one primary exception: access to London Heathrow.

Since most European countries already have open skies agreements with the U.S., there are very few limitations on the rights of U.S. airlines to serve points throughout Europe. London Heathrow, Europe's largest and most significant airport for U.S.-Europe travel, is closed to entry by additional U.S. airlines by the U.S.-U.K. bilateral air transport agreement, and it would remain effectively closed to additional U.S. airlines even if the U.S.-Europe multilateral open skies agreement were signed because competitive slots and facilities will not be available at London Heathrow to remedy the effects of years of discrimination against Continental and other U.S. airlines denied entry at London Heathrow. (See the attached report by the London Heathrow slot coordinator.) Absent the provision of competitive, economically-viable slots and facilities to Continental and other U.S. airlines historically excluded from London Heathrow, the greatest single impediment to free and fair U.S.-Europe competition will remain in place with or without a U.S.-EU multilateral agreement. The right to fly is meaningless without the right to land.

Usurping Congress's role in determining the scope of permitted foreign control over U.S. airlines for the purpose of securing an agreement with the European Union for the meager benefits to combination carriers and the passengers they serve that might result from such an agreement would be a poor trade at best. Without competitive, economically-viable slots and facilities at London Heathrow—the primary bottleneck for effective U.S.-Europe competition—available to independent U.S. airlines such as Continental, reaching an agreement by standing the "actual control" standard on its head would be a travesty.

We believe the Department of Transportation should go back to the drawing board on its proposed rule and on the EU treaty. As to foreign ownership, the Department of Transportation should stop trying to take the law into its own hands and should instead persuade the Congress to change the law in a way that opens additional access to capital markets while meeting the national needs. As to the EU deal, the U.S. should go back to the bargaining table and insist on fair access to slots and facilities at London Heathrow so U.S. carriers like Continental will be able to compete, from day one, on a level playing field.

Thank you for this opportunity. I am happy to answer the Committee's questions.

AIRPORT COORDINATION LIMITED
6 February 2006

Briefing Note: EU-U.S. Open Skies and Access to Heathrow Airport

The EU-U.S. "Open Skies" Air Transport Agreement of 18 November 2005, if approved, would authorise every EU and U.S. carrier to fly between any EU and U.S. city pair. The current Bermuda II limitations on transatlantic operations at Heathrow Airport would be removed.

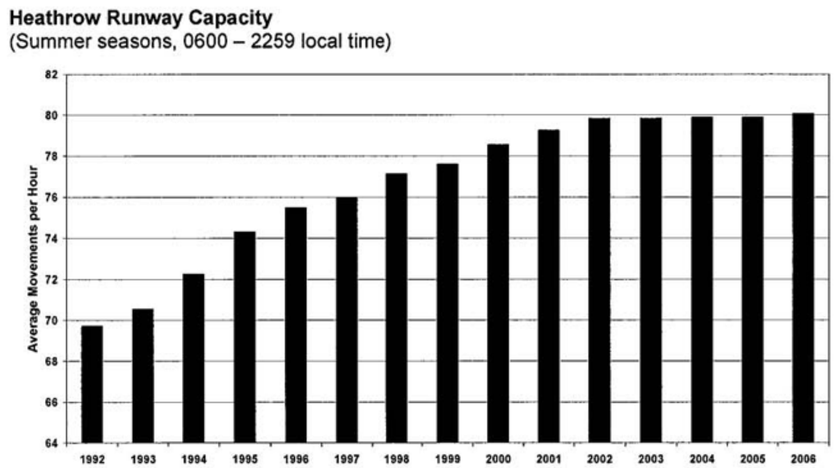
ACL is the independent coordinator, appointed in accordance with the EU Slot Regulation, with sole responsibility for the allocation of Heathrow slots. We have received a number of inquiries about the availability of Heathrow slots and the process of slot allocation. We are issuing this briefing note in the interests of openness and transparency and to provide all interested parties with a common set of information and advice.

Slot Availability

Heathrow is the world's busiest international airport, with 68 million passengers and 472,000 air transport movements in 2005. Its facilities are also very constrained. There are physical constraints on runway, terminal, and apron capacities, and environmental limits on the number of night flights and air transport movements.

Heathrow slots are highly scarce and demand far outstrips supply. Incumbent carriers have grandfather rights to about 97 percent of the airport's capacity. Grandfather rights are subject to a use-it-or-lose-it rule, but the failure rate is less than 0.5 percent each season.

There has been little increase in runway capacity since 2002, after a decade of steady improvement. Slots are particularly scarce during the morning period. Capacity is reviewed in advance of each season, but no new landing slots have been added between 0600—1259 (local time) since 1998.



The U.K. Government places strict limits on flights during the night quota period (2330–0600 local time). Heathrow's quota equates to about 15 flights per night and is fully allocated to established air services.

The U.K. Government also introduced a limit on the annual number of air transport movements as a condition of approval to build Terminal 5. The limit is fixed at 480,000 annual ATMs, which is only 1.7 percent higher than current traffic levels. The ATM Cap will become the dominant scheduling constraint within the next 18 to 24 months.

Future Capacity

Terminal 5, due to open in Spring 2008, provides the terminal and apron capacity necessary for Heathrow to grow to over 80 million passengers per annum. It does not address the shortage of runway capacity, however, and brings with it the ATM Cap condition.

The U.K. Department for Transport plans to consult this year on the possibility of mixed mode operations at Heathrow. Currently the two runways at Heathrow are operated in segregated mode: one runway is used for takeoff and one for landing, and the runway use is alternated each afternoon to provide noise relief for the local community. Operating in mixed mode (using both runways for takeoff and landing at the same time) would provide additional runway capacity but, if approved, is unlikely to be available before 2010. Government permission to lift the ATM Cap is also necessary if the new capacity is to be used for growth.

The U.K. Government's *Future of Air Transport* White Paper, published in December 2003, supported the development of a 3rd runway at Heathrow, but not before 2015 and only if stringent environmental limits can be met.

Allocation Priority

The liberalisation of a bilateral agreement does not make airport slots available or confer any special allocation priority. Some carriers, such as the U.S. carriers currently restricted to Gatwick under Bermuda II, will qualify as "new entrants" to Heathrow. This gives them priority in the allocation of 50 percent of pool slots. However, the lack of pool slots at viable times for transatlantic services means that new entrant status is of little practical value.

Slot Mobility

Slots are not route specific, so incumbent operators could add new transatlantic services using their existing slots. British Airways and Virgin Atlantic could add transatlantic frequencies; American Airlines and United Airlines could operate to new U.S. gateways; and other EU carriers such as BMI, Lufthansa or Air France could enter the Heathrow-U.S. market.

Slots may be exchanged, one for one, between air carriers. Slots may also be transferred between air carriers by way of a slot exchange. Carriers like Continental, Delta, Northwest and U.S. Airways could use this mechanism to acquire Heathrow slots from alliance partners or from the secondary market more generally.

All transfers and exchanges are subject to confirmation of feasibility by the coordinator, in particular that the change of use does not cause prejudice to airport operations. For example, there may be insufficient terminal or apron capacity to accommodate a change from shorthaul to transatlantic operations using a larger aircraft.

Prior to the opening of Terminal 5 in 2008, shortages of terminal and apron capacity will limit the number of new transatlantic services that can be accommodated. The number of feasible new services will depend critically on the exact slot times, aircraft size, and terminal of operation. It will also depend on how rapidly new services are introduced and how flexible carriers can be to fit within the airport's constraints.

Winter 2006/07 Coordination

The EU-U.S. Air Transport Agreement will require approval by the EU Transport Council of Ministers, which meets on 8–9 June 2006. The agreement could be applied from the start of the Winter 2006/07 season. However, carriers must submit their winter slot requests by 11 May 2006 and the initial allocation of slots must be complete by 1 June 2006.

ACL will accept slot requests for new transatlantic services in advance of approval of the agreement. Given the lack of suitable slots at Heathrow, we do not expect to be able to make any slot offers from the pool. Any new transatlantic services are likely to be sourced from carriers' existing slot portfolios and the secondary market.

JAMES COLE,
Director of Coordination.

HEATHROW SLOT AVAILABILITY
All times UTC

Winter 2005/06 (Typical week)

ARRIVALS							
Time	MON	TUE	WED	THU	FRI	SAT	SUN
0600	0	0	0	0	0	0	0
0700	0	0	0	0	0	1	2
0800	0	0	0	0	0	0	4
0900	0	0	0	0	0	0	1
1000	0	0	0	0	0	0	0
1100	0	0	0	0	0	0	0
1200	0	0	0	0	0	0	0
1300	0	0	0	0	0	0	0
1400	0	0	0	0	0	0	2
1500	0	0	0	0	0	0	0
1600	0	0	0	0	0	3	0
1700	0	0	0	0	0	0	0
1800	0	0	0	0	0	0	0
1900	0	0	0	0	0	6	0
2000	0	0	0	0	0	9	0
2100	3	1	0	0	2	13	2
2200	1	2	2	1	2	12	0

DEPARTURES							
Time	MON	TUE	WED	THU	FRI	SAT	SUN
0600	0	0	0	0	0	5	11
0700	0	0	0	0	0	3	6
0800	0	0	0	0	0	0	1
0900	0	0	0	0	0	0	0
1000	0	0	0	0	0	0	0
1100	0	0	0	0	0	0	0
1200	0	0	0	0	0	0	0
1300	0	0	0	0	0	0	0
1400	0	0	0	0	0	0	0
1500	0	0	0	0	0	3	0
1600	0	0	0	0	0	3	0
1700	0	0	0	0	0	2	0
1800	0	0	0	0	0	9	0
1900	0	0	0	0	0	8	0
2000	0	0	0	0	0	8	0
2100	6	0	6	3	1	6	0
2200	4	6	3	2	3	0	1

Summer 2006 (Typical week)

ARRIVALS							
Time	MON	TUE	WED	THU	FRI	SAT	SUN
0500	0	0	0	0	0	1	1
0600	0	0	0	0	0	0	2
0700	0	0	0	0	0	2	1
0800	0	0	0	0	0	0	1
0900	0	0	0	0	0	0	0
1000	0	0	0	0	0	0	0
1100	0	0	0	0	0	3	0
1200	0	0	0	0	0	0	1
1300	0	0	0	0	0	0	0
1400	0	0	0	0	0	0	1
1500	0	0	0	0	0	0	0
1600	0	0	0	0	0	0	0
1700	0	0	0	0	0	0	0
1800	0	0	0	0	0	5	0
1900	0	0	0	0	0	6	0
2000	6	2	2	4	5	20	5
2100	4	3	4	4	2	13	3

DEPARTURES							
Time	MON	TUE	WED	THU	FRI	SAT	SUN
0500	0	0	0	0	0	6	11
0600	0	0	0	0	0	3	8
0700	0	0	0	0	0	2	2
0800	0	0	0	0	0	0	0
0900	0	0	0	0	0	0	0
1000	0	0	0	0	0	0	0
1100	0	0	0	0	0	0	0
1200	0	0	0	0	0	0	0
1300	0	0	0	0	0	0	0
1400	0	0	0	0	0	0	0
1500	0	0	0	0	0	[illegible]	0
1600	0	0	0	0	0	1	0
1700	0	0	0	0	0	3	0
1800	0	0	0	0	0	2	0
1900	0	0	0	0	0	9	0
2000	5	0	4	1	0	9	1
2100	3	2	2	2	2	2	2

Senator BURNS. Thank you very much.

Now we'll hear from Mr. Michael Whitaker, Senior Vice President of United Airlines. Thank you for coming, sir.

STATEMENT OF MICHAEL G. WHITAKER, SENIOR VICE PRESIDENT—ALLIANCES, INTERNATIONAL AND REGULATORY AFFAIRS, UNITED AIRLINES

Mr. WHITAKER. Thank you, Mr. Chairman. I'm afraid I don't have an interesting parable about Senator Inouye taking over the Commerce Committee, but I do want to talk about the long-term health of the industry.

U.S. passenger airlines have lost their position of leadership in global aviation. United, American, and Delta are no longer the big three. Air France, Lufthansa, and Japan Airlines now hold those spots.

This committee is very familiar with the decline of the U.S. airline industry over the last 5 years. Network carriers have lost over $40 billion—billion with a "b"—since 9/11, and over 100,000 airline jobs have been eliminated. And though many airlines have dramatically improved cost efficiencies in recent years, at $75 a barrel for oil, even the most efficient of the U.S. carriers struggles to reach profitability.

What you may be less familiar with is the fact that our international competitors have fared much better, even in the face of $75 oil. While the U.S. industry lost $10 billion last year, our competitors in Asia and Europe enjoyed profits of nearly $5 billion. These airlines are growing, investing in their products, and buying new airplanes.

The poor results in the U.S. have a real impact on our economy, on jobs, and on other U.S. businesses. As an example, Boeing's latest aircraft, the 787, has attracted 350 orders in the short time it's been on the market. Only 25 of those orders, a mere 7 percent, are from U.S. passenger airlines.

One reason the U.S. airlines suffer so much is that, unlike other industries, we have been prohibited from taking full advantage of international opportunities to spread our business risk. During our prosperous years, we were prohibited by law from investing in operations outside the United States or from building foreign hubs that would have diversified our exposure to economic downturns. These restrictions have limited our access to the most vibrant growth markets in the world, including China and India. And because we've been unable to spread our business risks geographically, we are unable to flatten the drastic peaks and valleys of the airline business cycle.

In most sectors of the U.S. economy, companies have the right to invest abroad, and their foreign competitors have the right to invest in the United States. This is true for the automotive sector, oil and gas, telecommunications, insurance, financial services, and virtually all manufacturing businesses. Foreign investment in these areas has not led to a decline in safety or security in the United States, as some opponents of the NPRM suggest, nor has it harmed our economy. In fact, the opposite is true. By all accounts, the U.S. has been a net beneficiary of globalization, and our economy has been strong for decades.

U.S. airlines cannot gain the right to invest abroad unless a reciprocal right exists in the United States. And while DOT's rulemaking proposal does not eliminate the legal restrictions on foreign investment, it is an important step in the right direction. It is the right policy direction to enable the U.S. airline industry to begin to regain its position of leadership.

Much of the debate around the NPRM has focused on the CRAF program and service to small communities. In truth, these issues are no more than red herrings raised by parties with other agendas. U.S. carriers participate in CRAF and serve small communities because it makes business sense to do so. As Senator Lautenberg said, "Business is business." We serve small communities either because we are paid to do so under the Essential Air Service program or because those services add economic value to our networks. Likewise, there are economic incentives to participate in CRAF. We participate in that voluntary program, because we gain the right to bid on valuable government traffic.

These economic principles and incentives operate in any language and are understood by airline managers of whatever nationality. The government should not allow one company's short-term commercial interests, however disguised, to interfere with completing the work of deregulation. What this debate should be about is how to remove the remaining regulatory limits that keep our network carriers from prospering. The NPRM is one important step toward eliminating the outdated restrictions on foreign investment that apply stubbornly and uniquely to the airline industry. Allowing the NPRM to proceed will also facilitate the conclusion of the U.S.-EU Agreement, another important step in completing the deregulation of direct access to foreign markets.

Together, these initiatives will allow this industry to participate more fully in the global marketplace and regain its leadership position. Now is precisely the time to remove these protections. The restructuring this industry has undergone in recent years has strengthened our ability to compete effectively in any international arena. We are looking for opportunities to compete more effectively in the world market, not for regulatory protection against foreign competition or foreign investment.

Thank you, again, for the opportunity to testify, and I'm pleased to answer any questions.

[The prepared statement of Mr. Whitaker follows:]

PREPARED STATEMENT OF MICHAEL G. WHITAKER, SENIOR VICE PRESIDENT—ALLIANCES, INTERNATIONAL AND REGULATORY AFFAIRS, UNITED AIRLINES

Mr. Chairman, members of the Committee, thank you for the opportunity to present the views of United Airlines on the Department of Transportation's (DOT) proposal to reduce regulatory barriers and expand investment opportunities for U.S. and foreign carriers in the global aviation market. As the Nation's largest international airline, we strongly support the elimination of outmoded restrictions that discourage cross-border investment in the airline industry. Excessive restrictions on the ability of foreign investors to participate in the commercial management of U.S. airlines—and reciprocal restrictions that other countries impose on U.S. investors in foreign airlines—constrain our ability to tap global capital markets and to compete most effectively in the international marketplace.

The DOT last week published a 74-page supplemental rulemaking proposal (SNPRM) that refines the proposal on which today's hearing focuses. While we are closely reviewing that document, and expect to submit detailed comments on it,

United wishes to make clear that it supports the overall direction DOT is taking, and fully endorses the process in which the Department is engaged.

Facilitating a more market-oriented environment for cross-border investment is a natural, logical, and necessary extension of longstanding U.S. open skies policy for aviation. With the strong support of several Administrations, Republican and Democratic, that policy has already done much to transform international aviation from a highly-regulated, government-directed sector to a robustly-competitive worldwide enterprise at least partly guided by free market forces. In just 15 years, the U.S.-led open skies campaign has afforded U.S. and foreign airlines much greater freedom to traverse the globe without artificial limits on where, when, and how often they can fly, what they can charge, or how they can market their international services.

The DOT proposal to facilitate cross-border investment by enabling meaningful foreign investor participation in the commercial management of the airlines in which they invest represents another significant and positive step along this same market-opening path—a path that started with the 1978 deregulation of the domestic airline industry. We would prefer that DOT go further and eliminate, reciprocally, all limits on foreign ownership and control, except as they relate to national security oversight. But we welcome this progress toward the ultimate goal of allowing the airline sector to operate with the same freedom and flexibility as any other global U.S. industry—like financial services, energy, and telecommunications.

That is the only goal that makes sense in today's global economy—one in which our international passengers can readily access their multinational bank accounts, stay in international hotel chains, and connect with worldwide communications networks on a global basis. In today's business world, it is profoundly ironic that U.S. international airlines—the quintessential infrastructure of the global marketplace—remain bound by regulatory restrictions of a bygone era.

The DOT proposals to encourage cross-border airline investment come at an important moment, and should not be unnecessarily delayed or unduly limited in scope. The benefits are very clear—not only for the financially-challenged U.S. airline industry, but also for consumers and communities, and for U.S. international competitiveness.

U.S. airlines have undergone tremendous financial stress over the last 5 years, and today face escalating fuel and other costs that threaten the balance sheets of every major airline. We at United have come through a difficult and extended bankruptcy—one of the largest ever in the U.S.—in a process that required sacrifice and painful adjustment for thousands of employees and businesses across the country. We have emerged with a much more stable financial base—unit costs down 20 percent (excluding fuel), anticipated annual average cost savings of $7 billion through 2010, and productivity up by 27 percent. Despite these hard-won gains, we must further build our financial strength to respond to tough competition and extraordinary fuel prices. We and virtually all of our U.S. competitors must be able to continue to attract new capital investment in response to market forces and incentives, without undue regulatory impediments.

Enhancing opportunities for investment is also plainly in the interest of not only U.S. airlines, but also of the many communities that depend on financially-stable and successful U.S. airlines for their economic well-being, jobs, and needed air services. Ironically, some have suggested that allowing more foreign participation in the management of U.S. airlines would somehow undermine U.S. carrier service to smaller markets. Except for certain markets within the Essential Air Service (EAS) program, in which service is legally guaranteed, domestic markets are served because they generate adequate revenues for the airlines. There is no basis to assume that foreign managers would have less of a profit motive than U.S. citizen managers, and would drop profitable services to communities now being served.

The DOT proposal is far more than a matter of attracting foreign capital to U.S. airlines, though. We at United also look at it from the standpoint of potential U.S. investment in, and partnership with, foreign airlines (DOT properly proposes to offer the benefits of its proposal only to investors of those foreign countries that afford U.S. airlines reciprocal investment freedoms). We hope that the proposal, when finalized, will remain sufficiently broad to meaningfully facilitate U.S. carrier investment in, and integration with, foreign carriers in key markets. In the long run, the enduring path to aviation industry success is to become more competitive, embracing opportunities for international growth, integration, and inter-carrier cooperation and consolidation, including through strategic cross-border investments.

Significantly, the DOT proposals afford particular impetus to longer-term, strategic investment in U.S. airlines—investment by those interested in building and maintaining airline businesses, not just venture capital or hedge funds seeking transitory investment gains. Short-term, speculative investors are unlikely to be con-

cerned about participating in the commercial management of their investment targets. In contrast, the DOT proposal will encourage the kind of longer-term strategic industry investment—whether by foreign investors in the U.S. or by U.S. airlines in foreign carriers—that can play an important role in stabilizing the volatile airline sector.

Expanded foreign investment opportunities would enhance the scope and level of inter-carrier integration that has been shown to benefit consumers. Specifically, it would enable airlines to take today's alliance-based airline cooperation to the next level by facilitating cross-carrier equity investment and participation in business decision-making. Such investment and financial commitments would cement and strengthen the inter-carrier relationships that today rest solely on contractual agreements, albeit in some cases enhanced by DOT-granted antitrust immunity.

From a broader policy perspective, strategic cross-border airline investment may be the surest way to enlist market forces to help stabilize a global industry—a sector that is notoriously sensitive to world economic shifts and regional booms and busts, and vulnerable to unpredictable geopolitical events. Such global diversification among international airlines enables carriers in one region to broaden their financial exposure to other regions where growth and demand may be relatively strong, and so help flatten the often drastic and cyclical peaks and valleys of airline operations and profitability. Conversely, global equity-based financial exposure can help spread risk—and so avoid the potential catastrophic impact of what has become for aviation the expectation of the unexpected—from SARS to terrorism to the potential for avian flu. Strategic cross-border investment can also help normalize airline industry structure, eliminating some of the inefficient and destructive fragmentation of the international airline market.

Opponents of the DOT proposal have predictably failed to focus on its benefits for U.S. aviation competitiveness in the global economy. Instead, they have sought to stoke overblown fears that allowing minority foreign investors to participate in certain commercial management decisions of U.S. airlines will somehow subvert the safety and security of U.S. aviation. Such misplaced efforts to protect U.S. aviation from foreign competitors obscure the opportunities for U.S. airlines to regain their historic primacy in the global marketplace.

Historic U.S. leadership of global aviation—and scores of other global industries—has long been built on forward-looking, risk-taking competitive zeal, not on protecting U.S. flag companies from foreign competition or foreign investment. Reducing some constraints on the regulatory conditions now imposed on cross-border investment can help bolster U.S. competitive strengths and entrepreneurial resilience in an international marketplace where the opportunities are manifest. While North America's share of world air traffic is projected by Boeing to shrink from 25 percent to 20 percent over the next two decades, for example, the share of all intra-Asia markets will grow from 16 percent to 20 percent. And while domestic air traffic grows only 3.5 percent annually during that period, transatlantic traffic is projected to grow by 4.6 percent annually, at the same time traffic to Southeast Asia and China jumps every year by 7.3 percent and 8.0 percent respectively—more than *double* the rate of North American growth.

With improved cost efficiencies and renewed competitive strength in important international markets, we at United are eager to pursue these global service opportunities, including through partnerships with foreign airlines. Over the last 3 years, we began service to 12 new foreign cities, increased the number of foreign routes we serve by 44 percent, and grown our overall international departures by 31 percent.

In the end, efforts to protect U.S. airlines by restricting cross-border investment, or by other means, just do not work. To the contrary, since European regulators facilitated and encouraged open cross-border investment within the European Union, international aviation leadership has been shifting from U.S. carriers to such combinations as Air France/KLM—now the world's largest airline by revenues. And U.S. carriers now lag far behind their Asian and European competitors in the acquisition of new long-haul jet aircraft—with no U.S. passenger orders for the super-jumbo Airbus 380, and only a relative few for the high-efficiency Boeing 787 or Airbus 350 aircraft.

Mr. Chairman, while the DOT airline investment initiative has real merit on its own, it is also a fact that the pending agreement to create a full open skies aviation market between the U.S. and Europe will not occur without significant progress on this issue, as the Europeans have made abundantly clear. We would not support a bad DOT policy simply to gain European approval of the pending agreement, nor do we see any reason to believe the U.S. Government would do so, but it is essential to understand the importance of the U.S.-EU agreement that may hang in the balance here. We fully support the U.S.-EU agreement, in light of the open skies and

operational flexibility benefits it offers us and other U.S. airlines. And we do so even though it will expose United to significant new competition from major European airlines, as well as from U.S. competitors on certain key routes.

The proposed U.S.-EU agreement would enable any European airline, regardless of its nationality, to fly to anywhere in the U.S. from any city in Europe, not just from the airline's homeland. Together with the proposed new investment policy, the agreement would mean more competition for United—including from foreign airlines serving key U.S. markets from London's Heathrow airport, where we are now one of only four U.S. and European airlines authorized to serve that airport. In addition, a new transatlantic open market agreement would open Heathrow service to other U.S. airlines as a matter of law. United recognizes this competitive reality, and is prepared to accept this commercial challenge. We are willing to pay this competitive price because, in the long run, we will only succeed if we can prevail in a truly open global market. United and other U.S. airlines can do so, and can reassert U.S. aviation leadership, but only if they are prepared to compete efficiently and effectively as normal businesses on a global playing field.

Not every U.S. carrier has taken this long-term view. Indeed, even some who actually stand to gain in the short-term—like Continental Airlines, which would obtain legal access to Heathrow Airport under a U.S.-EU agreement—have loudly and extravagantly protested. To be frank, Mr. Chairman, we are surprised at the degree of rancor that this relatively modest DOT proposal appears to have generated, albeit by a small minority of U.S. airlines. Looked at fairly, the DOT proposal is essentially an incremental step—albeit an important one—along an extended path to a fully-deregulated, market-based, global industry. The proposal does nothing to affect the actual foreign ownership statutory requirements—that U.S. citizens own 75 percent of voting stock and serve as President and two-thirds of every U.S. airline's Board; rather, it would relax only the regulatory interpretation of the regulatory control requirement.

The SNPRM issued last week makes even clearer that DOT's proposal would not infringe on U.S. citizen control of U.S. airlines. Aside from even more specifically ensuring U.S. citizen control over issues relating to safety, security, and Defense Department obligations of U.S. airlines, the SNPRM makes explicit that the U.S. citizen-dominated Board of a U.S. airline maintains actual control of the airline. Particularly with this clarification, it is difficult to see any remaining basis for legitimate concerns about U.S. control. To the contrary, it will be important to ensure that DOT's effort to clarify this issue in its SNPRM does not provide fodder for opponents of the proposal—here and abroad—to argue that it now does not go far enough to encourage foreign investment.

The other significant source of concern about the DOT proposal, voiced by part of the organized labor community, is that the proposal could lead to fewer or less desirable jobs for U.S. airline workers. The fact is that U.S. airline labor has borne much of the burden as airlines have struggled to cut costs, increase efficiency, and compete effectively in an extraordinarily competitive environment. But it is impossible to see how the proposal to encourage more investment in their U.S. carrier employers can realistically make matters any worse for U.S. labor. Nor is it clear why foreign participation in a U.S. airline's managerial decisions would increase outsourcing of that airline's operations, including maintenance or long-haul operations, where the economics did not dictate such a shift. To the contrary, U.S. workers could only benefit from a more robust and competitive U.S. airline industry.

Given the circumscribed nature of the regulatory step at issue here, it is clear that much of the high-pitched opposition to it is generated by those pursuing other individual agendas. DOT's critics raise exaggerated fears of minority foreign investment in U.S. companies, and of appeasement of European interests, while virtually ignoring the numerous direct benefits of U.S. investment in foreign airlines, and the broader importance of maintaining global momentum for open aviation markets, free trade, and investment freedom. Regrettably, such objections are not entirely unexpected. Virtually every significant step toward aviation liberalization has met unwarranted opposition—from the 1978 deregulation of the U.S. domestic industry, to the pursuit of global open skies policy more than a decade later, to the current DOT proposal on foreign investment.

Mr. Chairman, DOT's proposal to facilitate cross-border airline investment, together with the transatlantic open market agreement we hope it will encourage, represents an important step for U.S. and international aviation—one that works to the benefit of a resilient U.S. airline industry and to consumers. Especially as the proposal moves toward freeing airlines from anachronistic marketplace distortions, and in the direction of enabling U.S. airlines to compete like other global businesses, it can help bring about a more fully deregulated environment in which U.S. carriers can regain their historic global aviation leadership.

We urge the Committee to support this modest effort, and we also take the opportunity to encourage DOT to maintain its focus on achieving the many, critical deregulation goals that remain. In today's competitive international airline industry, the only path that makes sense is the one that leads toward full deregulation, and the elimination of restrictions that continue to hold back U.S. carriers.

Thank you again for the opportunity to appear and present the views of United Airlines. I would be pleased to respond to any questions of the Committee.

Senator BURNS. Thank you, Mr. Whitaker. We appreciate that.

Now we'll hear from Captain Duane Woerth, President, Air Line Pilots Association. Welcome, and thank you for coming.

STATEMENT OF CAPTAIN DUANE WOERTH, PRESIDENT, AIR LINE PILOTS ASSOCIATION (ALPA)

Mr. WOERTH. Thank you, Mr. Chairman. I'd like my statement be entered into the record, my full statement, please. And I——

Senator BURNS. Your full statement will be a part of the record.

Mr. WOERTH. I represent, as you know, 62,000 pilots, United States and Canada, from 39 airlines. And we believe the original NPRM, and the supplemental, are flawed public policy, for a number of reasons.

First, the NPRM is the wrong process. Only Congress should amend foreign ownership laws which prohibit actual foreign control. Let's have a real debate, starting with S. 2135, which ALPA supports. The NPRM does not distinguish adequately between types of foreign investors. Private citizens, mutual funds, foreign airlines, and even government-owned airlines are all essentially the same. I do not accept that the reciprocity requirement is adequate to defend against this. Some states have a state-owned or a "golden share" airline, but they also have other airlines, so it would be permissible to buy a small airline, while somebody buys United. I think the reciprocity piece is simply not good enough.

The NPRM also has faulty assumptions about American corporate governance. As was stated before, safety and security simply cannot be carved out separately. I also do not agree that a major shareholder with 25 percent cannot control a U.S. corporation. It happens every day. It's happening all over the Fortune 100. The rest of the diversified investors do not operate as one, and a majority investor can soon get control of the board.

The supplemental assumes a rebelling in the ranks in the board that would somehow revoke the decisions made by majority, and I must say, frankly, this does not pass the laugh test of the corporate board I served on, which was Northwest Airlines.

In the real world, Board members are recruited. They're not come out of the—they're not elected. They are recruited, usually by the Chairman and the CEO. And after a couple of years, the largest investor will successfully nominate a slated Director who's satisfactory to the majority investor. And that includes independent directors who know how they got on the board in the first place.

And, incidentally, the supplemental rule is only one page long. Just one page. But the DOT has added 74 pages of explanations and assurances about how the threats to foreign control could be mitigated. Unfortunately, none of these ideas actually are in the rule itself, and are unenforceable by any realistic standards. In other words, where I come from, the supplemental appears to be all hole and no donut.

The NPRM assumes U.S. airlines are clamoring for foreign airline capital. The truth is the NPRM represents the wish list, and now the demand, of EU airlines, not U.S. airlines, and certainly not U.S. airline employees. As you all—you all know the executives of our airline industry; they're not bashful about asking Congress for something, but they're not lined up outside your doors asking to get this NPRM through. They're not doing it. I don't see where the push is in U.S. interests.

Congress should not be stampeded into a rushed blessing of a deeply flawed NPRM simply to satisfy the arbitrary and artificial deadlines represented by scheduled meetings of EU ministers. And, incidentally, the EU ministers, which, by the way, failed to ratify our first EU-U.S. Open Skies, that agreement, they could have already had, but they shot it down. We negotiated, in good faith. They shot it down.

Now, ALPA, I want to make clear, does support the EU Open Skies Agreement. We wish it was already in effect, and we hope the new agreement would be voted on by the European Union. I think I need to say that I find very objectionable preconditions or side deals to good-faith negotiations between the United States and the European Union or anybody else, for that matter. I think Chairman Mica might have stated, if I heard him correctly, that our negotiating credibility was at risk. I think it's just the opposite. We negotiated in good faith twice. They shot down the first deal, they're threatening to shoot down this deal. Our negotiating credibility isn't at risk; it's the European Union's credibility which is at risk.

Now, the NPRM simply ignores the real-world history of foreign airline investments in the United States, which ended up in significant boardroom conflicts of interest, which ultimately forced the divestiture of British Airways investment in US Airways, at a substantial profit, and of KLM's investment in Northwest, also at a substantial profit. I was on that board when the conflict occurred—lawsuits, huge conflict. It was finally resolved once the stock was gone. Now they've got a great joint venture. But while a foreign airline was in the Northwest Board, conflict was aplenty.

The US Airways pilots and flight attendants were replaced by British crews almost immediately after the investment in British Airways in US Airways. That—the routes to London were just gone, and it was taken over by the British. That is the one thing that our U.S. airline crews from United and Delta and Northwest and Continental across this country are aware of. They saw what happened there, and they're quite afraid that they're going to be replaced over time by their foreign counterparts.

And I might add, Mr. Chairman, that many of my pilots, almost 30,000 of them, serve Mississippi, and they serve Bozeman, Montana, and Billings. They serve North Dakota and Arkansas. And our regional pilots really wonder what's really going to happen. They know most of the passengers they fly are in domestic service. There's some traffic that flows across to Amsterdam and Paris and London and Frankfurt, but they're wondering what's going to happen to them if this NPRM would take effect.

So, bottom line, we support U.S.-EU Open Skies. We want it to occur. We don't think this should be a precondition. And we cer-

tainly hope that Congress would exert its efforts to control this process, and a little more lengthy debate on its vital interest would be worthwhile. We think we can amend foreign investment laws sensibly, but I'm sorry to say I don't think the NPRM is the way to go.

I'll answer any questions you have, Mr. Chairman.

[The prepared statement of Mr. Woerth follows:]

PREPARED STATEMENT OF CAPTAIN DUANE WOERTH, PRESIDENT, AIR LINE PILOTS ASSOCIATION (ALPA)

Good afternoon. I am Duane Woerth, the President of the Air Line Pilots Association. ALPA represents over 62,000 pilots at 39 airlines in the United States and Canada. We appreciate the opportunity to appear before this subcommittee today to present our views on the U.S. Department of Transportation's proposed policy on foreign control of U.S. airlines. While DOT has recently modified that proposal, we continue to have deep reservations about several of its substantive provisions and believe that Congress, rather than the Department, should determine the rules that apply to the ownership and control of U.S. airlines. We fully support S. 2135, which is designed to ensure that Congress has an opportunity for meaningful review of DOT's proposal and its implications, as well as Senators Inouye and Stevens' proposed amendment to the supplemental appropriations bill that would prohibit the issuance and implementation of DOT's proposed rule through the end of Fiscal Year 2006.

Background—The Proposed U.S.-EU Text

DOT's proposal is closely tied to the text of a possible air services agreement that was initialed by the U.S. and the European Union last year. In fact, the EU has expressly linked the outcome of DOT's rulemaking process to the EU's decision to finally accept or reject that initialed text. Accordingly, as a preliminary matter it is important to assess the contents of that text.

ALPA believes that the initialed text offers little to U.S. airlines, but much to their EU counterparts. That text would allow any European airline to fly from any point in Europe to any point in the U.S. and beyond. For example, Lufthansa could fly from Paris to Atlanta; Air France could fly from Munich to Chicago. Thus, the initialed text would solve the problems raised for the Member States of the European Union by the December 2002 European Court of Justice decision that found that the ownership and control clauses in the bilateral agreements between the United States and individual European Member States were illegal because they violated the right of establishment provisions of the EU's organizational statutes. The text would also facilitate the consolidation of European airlines, potentially allowing them to be more efficient and effective competitors *vis á vis* U.S. carriers. In addition, under the initialed text EU carriers would receive the right to provide aircraft and crew to U.S. airlines on international routes, a right they have long sought, but which appears to be in square violation of the Federal Aviation Regulations and directly threatens the jobs of U.S. airline pilots. Clearly the initialed text provides substantial benefits to EU carriers.

What would U.S. carriers get if the initialed text were to go into effect? Apart from some additional routes beyond European gateway points that our cargo carriers might use, not much. In June 2004, the U.S. Government Accountability Office issued a report titled "*Transatlantic Aviation: Effects of Easing Restrictions on U.S.-European Markets.*" That report contained an assessment of what U.S. carriers and consumers stood to gain if the U.S. entered into an "open skies" agreement with the EU that eliminated, as does the initialed text, the nationality restrictions on EU carriers. The GAO concluded that whatever benefit U.S. carriers and consumers would eventually gain from such an agreement would not be realized for several years. This, according to the GAO, is because the U.S. already has open access to the vast majority of European traffic and the only significant restricted market—London—is subject to significant airport capacity constraints that would not be eliminated by a liberalized agreement. In other words, in the GAO's view, U.S. carriers were not likely to benefit in the short term—and possibly only to a small extent even in the longer term—by a U.S.-EU "open skies" agreement similar to the initialed text.

But as favorable as the initialed text is for European carriers, they want more. Throughout the negotiations the European carriers sought the inclusion in any new

agreement of the right for them to own and control U.S. airlines. DOT's proposal is the Department's effort to satisfy this EU objective.

The Foreign Control Rulemaking

So let me turn to that rulemaking process and DOT's proposed policy change.

The Department's proposal was first issued on the eve of the round of negotiations that resulted in the initialed text. After reviewing the comments that were submitted on the proposal, DOT issued a supplemental proposal last week. That revised proposal would permit foreign interests to exercise actual control over all the commercial elements of a U.S. air carrier's business, including, apparently, such fundamental matters as the "definition of and quality of product, branding, fleet mix, origins and destinations, [and] network issues defining the business of the company." Under the proposal U.S. citizens would have to maintain actual control of only four areas:

> 1. The carrier's "organizational documentation, including such documents as charter of incorporation, certificate of incorporation, by-laws, membership agreements, stockholder agreements, and other documents of similar nature";
>
> 2. The carrier's "[d]ecisions whether to make or continue Civil Reserve Air Fleet (CRAF) or other national defense airlift commitments, and, once made, the implementation of such commitments with the Department of Defense";
>
> 3. The carrier's "policies and implementation with respect to aviation security, including transportation security requirements specified by the Transportation Security Administration"; and
>
> 4. The carrier's "policies and implementation with respect to aviation safety, including requirements specified by the Federal Aviation Administration."

As long as these four areas remain under U.S. control—and the other requirements of the statute relating to place of incorporation, ownership of voting stock, and the citizenship of managers and directors, are met—the Department would permit foreign citizens to control all other commercial elements of the carrier's business and operations. As United Airlines CEO Glenn Tilton put it in a recent speech the proposal "would allow foreign investors in U.S. airlines to effectively control the bulk of the airline's commercial operations."

We do appreciate DOT's consideration of the comments that were filed on the initial proposal and the Department's efforts to be responsive to some of the expressed concerns. We intend to examine the supplemental proposal closely and file our comments at the appropriate time. But even on a first reading, we believe there continue to be a number of flaws in the Department's proposal.

The Statutory Issue

First, even as revised, DOT's proposal is simply at odds with Congress's determination that actual control of a U.S. air carrier must be in the hands of U.S. citizens. While the four areas over which the Department would continue to require U.S. citizen control may have their importance, they are ultimately peripheral to an airline's core business operations and strategy. Control over the four narrowly defined areas simply does not add up to the "actual control" of the entire air carrier as required by Congress. The most critical issues that managers of a U.S. airline must address are such matters as the markets to be served, the type of aircraft to be flown, the alliances to participate in, the extent to which the carrier out-sources maintenance and other services, the carrier's schedules, fares, etc. These are the fundamental economic decisions that determine the very nature of an airline's operations, and its role in the air transportation system. In fact, DOT's application of the "actual control" test historically has been focused on the ability of foreign entities to control the economic and operational aspects of U.S. airlines. To permit these matters to be controlled by foreign citizens, as the Department proposes to do, simply cannot be reconciled with the statutory requirement that U.S. citizens retain "actual control" of the airline.

DOT's NPRM acknowledges that, unless Congress changes them, the Department cannot alter the statutory standards that define a carrier's U.S. citizenship—*i.e.,* the requirements relating to place of incorporation, ownership of the voting stock, and the citizenship of managing officers and directors—because they are mandated by law. The same is true of the "actual control" requirement. Indeed, the underlying purpose of *all* the statutory requirements is to ensure that U.S. citizens retain actual control of a U.S. airline. Without "actual control," the other statutory requirements are meaningless.

DOT's supplemental notice requires that "all delegations [of control] to foreign interests ultimately be revocable by the board of directors or shareholders." But this proposed "fix" does not address the fundamental problem—that foreign entities will

be permitted to be in actual control of key economic and operational aspects of U.S. airlines. The U.S. aviation statutes simply do not allow the dissection of airlines into components that can be under foreign control and those that cannot: the entire airline must be under U.S. citizen control.

Application of the "actual control" standard does require analysis of the specific facts and circumstances of each particular case and thus the Department does have some discretion to define the criteria for determining *whether* U.S. citizens have "actual control" of a carrier. That discretion, however, does not give the Department authority to change the plain meaning of the term "actual control" itself, so that control over such basic matters as a carrier's route selection, fare structure, or choice of aircraft is simply excluded from the definition of "actual control." This is not interpretation but legislation, and it is the province of Congress, not the Department.

Apart from the legal issues there are a number of policy issues raised by the Department's proposal.

The Impact on U.S. Airlines and Jobs

A key policy issue, in our view, is whether foreign air carriers should be permitted to acquire or exercise the kind of control over the basic business decisions and strategy of U.S. air carriers that the proposed rule change would permit.

The distinction is of crucial importance.

When one air carrier seeks to acquire control of another, the goal of the acquisition is almost always to combine the operations of the two carriers so as to create an integrated network. Since foreign carriers cannot operate domestically, the reason a foreign carrier would seek control of a U.S. carrier would normally be to combine the U.S. carrier's domestic services with the foreign carrier's international services. While this also occurs when U.S. and foreign carriers form alliances, an acquisition of control is very different from an alliance. In an alliance each carrier remains autonomous and able to protect its own economic interests. A very different situation would be created if a foreign carrier is permitted to acquire control of the key economic elements of a U.S. carrier's business strategy—such as route structure, schedules, fleet type, and the like. In such a situation, it is inevitable that the foreign carrier would exercise its control to maximize its own interests, not those of the U.S. carrier.

What would likely happen when a foreign carrier acquires control of a U.S. carrier is that the foreign carrier might well use the U.S. carrier to create a domestic network that would support and feed traffic to the foreign carrier's international operations. As a result, any pre-existing international operations of the U.S. carrier could diminish or disappear, while those of the international carrier would be expanded.

Such a result is fundamentally inconsistent with 49 U.S.C. § 40101(a)(15), which sets forth as a U.S. policy goal:

> *strengthening* the competitive position of [U.S.] air carriers to *at least ensure equality with foreign air carriers,* including the attainment of the opportunity for [U.S.] air carriers to maintain and increase their profitability *in foreign air transportation.* [Emphasis added.]

This goal simply could not be accomplished if foreign carriers are permitted to control the basic operations and business strategy of U.S. carriers.

The decline in international operations by U.S. carriers that would result from foreign control would also undermine the CRAF program, because it would necessarily cause a reduction in the number of long-range wide-bodied aircraft in the U.S. carrier's fleet. Although the Department's proposed rule attempts to protect the CRAF program by ensuring that U.S. citizens retain control of a carrier's CRAF commitments, the fact is that a foreign carrier that has economic control of a U.S. carrier would be able to determine how many CRAF-eligible aircraft the U.S. carrier has in its fleet. And it is predictable, for the reasons stated, that the foreign carrier's business strategy would cause that number to diminish over time.

The decline in international operations by U.S. carriers would also be injurious to U.S. airline workers, including in particular the pilots. International flying of wide-bodied aircraft is the most remunerative, and therefore the most desired, flying performed by pilots; pilots spend their entire careers accumulating the seniority required to gain access to such flying opportunities. In an era when the career expectations of pilots and other airline workers have already been repeatedly frustrated by airline bankruptcies, furloughs, wage concessions, pension plan terminations, and the like, it would be a crowning blow for the U.S. Government now to adopt a policy that would tend to eliminate international flying by U.S. carriers.

U.S. workers would also suffer injury because U.S. labor laws do not apply to foreign air carriers. When two or more U.S. carriers are commonly controlled, the employees of all of them are subject to the Railway Labor Act and therefore have the same collective bargaining rights and opportunities. This allows the employees on all the affiliated carriers to try to equalize their wages and working conditions, thereby preventing the carriers from playing one employee group against another. When one of the affiliated carriers is foreign and therefore not subject to the same labor law, the employees of all the affiliates are placed at a severe disadvantage and face the prospect of being bid against each other without effective recourse against the entity (perhaps a foreign holding company) that is allocating the work. These are not hypothetical concerns. In the early 1990's when British Airways bought into US Airways, and KLM bought into Northwest, flight crew jobs were either moved to or grew disproportionately at the foreign partner.

The validity of these concerns was recognized recently by a Working Group appointed by the American Bar Association's Air and Space Forum to study the issue of whether the statutory restriction on ownership and control of U.S. airlines. The Working Group issued a Proposed Position Statement (attached hereto) which, despite being favorably disposed to lifting the restrictions on foreign ownership and control of U.S. carriers, clearly recognized that ownership or control by foreign airlines should not be permitted until and unless special safeguards are enacted. The Working Group therefore recommended adoption of two important restrictions on foreign air-carrier control of a U.S. carrier. The first of these restrictions would require any foreign carrier that acquired control of a U.S. carrier to:

> ensure that the U.S. airline maintains at least the percentage of the combined total ASMs operated by both the U.S. airline and the foreign affiliates between the United States and any country or region that it had as of a date 6 months prior to the announcement of the acquisition. This condition ensures that the CRAF program has access both to a sufficient number of the appropriate (*i.e.,* long-haul wide-body) aircraft and to the crew necessary to fly them in a military emergency. It simultaneously ensures that U.S. jobs are not transferred to foreign entities.

The second restriction proposed by the ABA Working Group would require that "[t]he U.S. Government and the appropriate foreign government(s) . . . establish in advance a legal framework containing fair procedures to regulate labor representation and collective bargaining on such multinational airline systems." The purpose of this recommendation, of course, is to eliminate the unfair advantage that would otherwise result if the U.S. carrier and the foreign carrier were subject to different rules relating to labor representation and collective bargaining.

While ALPA does not endorse the Proposed Position Statement of the ABA Working Group, we do believe the statement has at least identified the basic concerns that must be addressed if any change is to be made in existing rules relating to foreign ownership or control of U.S. air carriers.

In its supplemental notice DOT attempts to address some of these concerns. We will examine and respond fully to DOT's suggestions in our comments on the supplemental notice. However, we would make some preliminary observations.

First, DOT states that even if foreign entities control the operations of a U.S. airline that airline would still be subject to the Railway Labor Act and thus "all employees at any U.S. carrier would retain all the protections created by United States' labor laws." But that truism has never been at issue. The concern, as stated above, is that U.S. labor laws may be inadequate to deal with the job allocation issues that may arise if two airlines subject to two separate sets of labor laws are under common ownership.

Second, DOT concludes that if a foreign investor who had been delegated authority to control of a U.S. airline were to shift long-haul flying to a foreign carrier U.S. investors would withdraw the delegation of authority if the transfer was contrary to the interest of the U.S. carrier and the U.S. citizen investors. The conclusion simply does not square with the reality of how board rooms work, especially in publicly-held companies where the foreign investors may be far and away the largest and most dominant shareholders. Moreover, while DOT discusses at length the right of U.S. shareholders or board members to revoke authority from foreign investors, the Department's actual policy (which is only a page long) says nothing about this right. Exactly, how the right would be enforced is obscure.

Third, DOT proposes to revise its initial proposal to require that U.S. citizens must control a U.S. carrier's commitments with respect to all national defense airlift operations. But the Department's supplemental rule still does not address the fact that foreign investors would be able to make fleet decisions that could eliminate all the aircraft suitable for CRAF operations. In other words, while U.S. citizens may

have to have control over honoring CRAF and other national defense airlift commitments once made, foreign managers could make fleet decisions that leave no aircraft available for the commitment in the first place.

The Impact on Safety

DOT's supplemental proposal discusses a number of safety concerns raised by ALPA and other commentators and proposes to broaden the language of the initial rule to clarify that "U.S. citizens must control the carrier's overall safety and security programs and policies, not just the carrier's compliance with the requirements of the FAA and TSA." ALPA will review DOT's assessment and file comments on the revised proposal. However, ALPA notes that safety and security issues are completely intertwined with operational and economic decisions and that whoever actually controls the operations of the airline is likely to ultimately control safety policies and implementation.

The Lack of Supporting Data

Finally, the Department has presented no data either to support its claim that the U.S. airline industry is in need of more foreign investment, or its claim that such investment is not available absent a change in the foreign control rules. We believe that the fundamental premise on which the supplemental NPRM appears to be based—that the U.S. airline industry is in need of enhanced access to worldwide financial resources, and that such access to foreign capital cannot be achieved without granting foreign investors substantial control of U.S. carriers—is erroneous. Certainly, the proposal contains no hard data to substantiate these propositions, and we are not aware that any such data are available.

In fact, there is evidence that when a U.S. airline shows some significant promise of profitability, it is able to find the capital it needs. For example, United Airlines, after engaging in extensive restructuring, cost-cutting and changes in operations and services while in Chapter 11, was able to obtain $3 billion in debt exit financing on terms that pleased United's management. The airline's own press release stated that it had received offers of subscription for more than twice the capital necessary to support the financing it sought and that the money was provided at rates better than it had expected to receive. Similarly, US Airways, after going through its own Chapter 11 restructuring and merging with America West, obtained $1.5 billion in exit financing, of which $350 million was in the form of equity commitments. Moreover, $75 million of the equity was foreign investment provided by ACE Aviation Holdings, the parent of Air Canada. These major financings strongly indicate that both foreign and domestic capital is available to U.S. airlines if they appear to offer a reasonable return to the investor.

If there is hard evidence that the U.S. airline industry is seriously suffering from a dearth of capital, and that the existing rules relating to foreign control are somehow responsible for the problem, that evidence has yet to be produced. Before lack of capital is used as a rationale for considering dramatic changes in the foreign control rules, there should be a thorough and systematic study to determine whether the problem it is attempting to cure actually exists.

Conclusion

DOT's proposal is based on two premises, both of which are erroneous. The first is that airlines need enhanced access to foreign capital to be competitive. But as we have shown above, U.S. airlines with sound business plans have been able to find ample capital on reasonable terms. The second is that Congress has decided "the airline industry should be largely deregulated (except of course, for safety and security regulation)." But the airline industry remains regulated in myriad ways, and just as safety and security have not been deregulated Congress has not deregulated airline citizenship; if anything, Congress has recently tightened the citizenship rules. DOT's proposal would essentially rewrite these rules. The Department's proposal could have broad, potentially negative effects on the competitive posture of U.S. airlines and their employees and raises a number of key public-policy issues that have not been adequately addressed by the Department. Consideration of changes of this magnitude should be undertaken not by an administering agency but by Congress. S. 2135 is thoughtfully designed both to afford time for Congress to consider whether a change to the control rules is appropriate and to help develop a record on which that consideration can be based and Senators Inouye and Steven's amendment to the supplemental appropriations bill would freeze further action by DOT while that bill moves forward. We urge this committee to support these measures and to ensure that the DOT does not unilaterally impose changes to the longstanding rules on "actual control" of U.S. airlines.

Air and Space Lawyer—Winter, 2005

WORKING GROUP POSITION STATEMENT ON RELAXING AIRLINE FOREIGN OWNERSHIP RESTRICTIONS

by American Bar Association

The Position Statement presented herein is a composition of the various forces that must be addressed if meaningful change is going to be made to foreign ownership of U.S. airlines. This proposal, which contains suggested changes to the law on foreign ownership and control, grew out of the efforts of the individuals whose names appear below the statement. The group met as part of and in preparation for a presentation to the Forum on Air & Space Law's Fall Meeting in Santa Monica, California, on October 28, 2004. The ex officio members participated in the deliberations leading up to the final draft but did not vote on approval of the final draft. Each participant may have personal views that vary from the consensus statement, but all were able to agree on the statement to reach a consensus. The consensus views do not necessarily reflect the views of any individual participants or their employers and/or clients.

Nor does the statement represent the views of the ABA or the Forum. The value of the proposal is less in its details (all of which are worthy of serious consideration) than in demonstrating the methodology/process by which competing interests may need to be accommodated. The Position Statement reflects the summation of research papers on various related subjects, including legislative history, *20 maritime law as it applies to foreign ownership of U.S. shipping interests, the Omnibus Trade and Competitiveness Act of 1988 (Exon-Florio) legislation and the operation of the Committee on Foreign Investments in the United States (CFIUS), Civil Reserve Air Fleet (CRAF) issues, and labor-related issues.

A principal objective of the deliberations was to critically examine the original justifications for the restrictions on foreign ownership and control and to determine what, if anything, about the airline industry might require the continuation of special rules that apply to almost no other industry.

Only one of the original justifications, as reflected in the legislative history, held validity—the national security concern. Specifically, how can we ensure that the Department of Defense (DOD) has access to sufficient lift with crews in times of national emergency? A second area of concern identified was that a change in the ownership and control rules could give rise to labor-management issues not adequately addressed by the current laws of the United States and other countries.

The Position Statement appears below:

Proposed Position Statement for Consideration by the ABA Air and Space Law Forum[1]

It is the recommendation of this Working Group that Congress amend the statutory restriction on foreign ownership and control of U.S. airlines, subject to the conditions set out below. Congress first restricted foreign ownership of U.S. airlines in the 1920s. The Civil Aeronautics Act of 1938 and its successor, the Federal Aviation Act of 1958, incorporated the current prohibition on substantial foreign ownership or control, to protect the heavily subsidized, fledgling airline industry and to provide for the national defense. That prohibition, embellished by years of regulatory interpretation by the Civil Aeronautics Board and the Department of Transportation (DOT), has served to strictly limit foreign ownership and control, and largely exclude foreign equity capital. It is the Working Group's judgment that, if certain safeguards are put in place, the statutory prohibition is no longer needed to protect our aviation industry or provide for the national defense.

Under our proposal, there would be no restriction on the ability of a foreign entity that is not an airline or an airline affiliate to invest in a U.S. air carrier, except for the following statutory safeguard to protect national defense:

1. Congress should amend the Transportation Code (49 U.S.C.) to require a foreign-owned U.S. air carrier to enter into a binding contract with the DOD that provides for participation in CRAF. To ensure compliance, a carrier must waive any objection to the DOD's obtaining a Federal Court injunction (including an injunction to allow seizure of any aircraft that the carrier has pledged to CRAF). If, following

[1] The Proposed Position Statement reflects the consensus views of the individuals whose names appear below the statement. The ex officio members participated in the deliberations leading up to the final draft, but did not vote on approval of the final draft. The views expressed in the Position Statement reflect the consensus views of those who fully participated and do not necessarily reflect the views of any individual participants or of their employers and/or clients.

DOD activation of CRAF, a foreign-owned U.S. air carrier fails to make available the aircraft and crews it has pledged, the DOT will automatically revoke the carrier's certificate of public convenience and necessity upon notification of such failure by the DOD.[2]

Moreover, a foreign airline or its affiliate would have the same opportunity to invest in a U.S. carrier subject to two additional conditions:

2. 50 percent of any incremental flying to and from the United States must be flown by the U.S. carrier, as measured by available seat miles (ASMs).[3] *In addition, the U.S. carrier must maintain a sufficient level of capacity on any major long-haul U.S. international routes (e.g., the transatlantic or the U.S.-Asia/Pacific). Specifically, the foreign-owned airline(s) controlling the U.S. airline shall ensure that the U.S. airline maintains at least the percentage of the combined total ASMs operated by both the U.S. airline and the foreign affiliates between the United States and any country or region that it had as of a date 6 months prior to the announcement of the acquisition. This condition ensures that the CRAF program has access both to a sufficient number of the appropriate (i.e., long-haul wide-body) aircraft and to the crew necessary to fly them in a military emergency. It simultaneously ensures that U.S. jobs are not transferred to foreign entities.*

3. The U.S. Government and the appropriate foreign government(s) would have to establish in advance a legal framework containing fair procedures to regulate labor representation and collective bargaining on such multinational airline systems.

Whether or not the foreign owner is an airline, a U.S. carrier that has foreign ownership or control, as a "U.S. air carrier," will be organized under U.S. law and operated subject to all U.S. laws and regulations (*e.g.*, safety, security, labor relations, environment, etc.) just as if it were fully owned by U.S. citizens. The current provisions of the statute with respect to the citizenship of U.S. airline officers and directors would remain in place. The current control and voting tests would be modified as set forth herein.

Any foreign entity seeking to control a U.S. air carrier (like any prospective U.S. air service provider) would have to apply to the DOT for a certificate of public convenience and necessity. If the (DOT-approved) foreign owner is an airline or its affiliate, conditions 1 and 2 would be incorporated into the certificates of both the foreign airline owner and the U.S. air carrier. (The DOD should participate in the DOT certificate-approval process to ensure that national defense is adequately considered.) If the applicant is a foreign airline that is owned in whole or in part by a foreign government, DOT would need to make a finding on the record that such investment by a government-owned entity would not harm competition or otherwise be contrary to the public interest.

Lastly, the rights provided for in our proposal extend only to nationals of those countries or regional entities that provide U.S. citizens with investment rights of comparable value.

Jonathan B. Hill, Chairman
Russell Bailey
Jonathan Blank
Richard Magurno
Jeffrey Manley
Dorothy Robyn
Mark Dayton, ex officio
Dwight Moore, ex officio

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[2] Consideration was given to amending the so-called Exon-Florio provision of the Defense Production Act to require notification of the Committee on Foreign Investments in the United States (CFIUS) if a foreign entity seeks to own more than 25 percent of the voting equity in a U.S. air carrier that operates long-haul wide-body aircraft suitable for the Civil Reserve Air Fleet (CRAF). This change (CFIUS notification is now voluntary in most cases) would ensure that the Department of Defense (DOD) and other U.S. Government agencies have the opportunity to block or condition a proposed airline acquisition on national security grounds, if appropriate. Because we are unaware of any instance where failure to notify has had a demonstrated detrimental impact on national security, we have determined not to recommend any changes in this area.

[3] That is, the foreign airline owner may operate, with its own aircraft and crews, no more than 50 percent of any incremental flying by the combined entity on U.S. international routes, as measured by ASMs. If the foreign airline owner reduces the amount of flying by the U.S.-based carrier on U.S. international routes, it must reduce its own flying on U.S. international routes by the same amount, as measured by percent of ASMs.

Senator BURNS. Thank you, Captain Woerth. I appreciate that very much.

Now, when we're talking about this today, we're mostly talking about passenger. Is—does—Secretary Shane, you're right behind—does this also pertain to cargo?

Mr. SHANE. Yes, sir.

Senator BURNS. It does. Cargo and the whole works. I was wondering about that. And does it concern any of you that it may be a state-owned airline that would be doing the investing in our domestic airlines here?

Yes?

Mr. SMITH. Well, as I mentioned briefly, the DOT approved the German government buying one of our competitors. The airline was separated to meet U.S. ownership laws, but we made the case, as did UPS, that the foreign entity was exercising *de facto* control, but not *de jure* control. And there must have been something to it, even though the DOT approved it, because it was restructured to have *bona fide* U.S. interests after that.

So, our point is, we don't care whether it's governments. We don't care who is involved, as long as we have the same opportunity to compete around the world. And that's a—that's embedded in this NPRM, this reciprocity, which was our point of opposing the DOT's approval of DHL. So, if you want a real-life example of this, all these hypotheses of the takeover of the Commerce Committee and one thing or another, just go in our industry. You see it right now. There are foreign interests that own them, 25 percent. They don't tell them, you know, what to do, other than they can be involved in coordinating schedules and so forth. It's a much better regime than this alliance situation, which gives, to foreign and U.S. carriers, immunity, which, in any other industry, Mr. Chairman, would be illegal. It would be a criminally sanctioned event. They can coordinate schedules. They can coordinate rates and so forth.

And, finally, the elephant in this room—you heard it twice here—was—is Heathrow. Heathrow means nothing to the cargo folks. What Continental, quite rightly, wants is access to Heathrow, because it's very important. The reason British Airways took over the flying when they invested in US Air wasn't because there was some conspiracy to do away with American pilots. It was because US Airways doesn't have any gates—authorities or slots into Heathrow, and British Airways did. And that was a very lucrative transaction.

So, this is not a simple issue here. And there are many competing interests. And that's one of the things that is very disheartening to FedEx and the other cargo interests who employ more people than the airlines put together, because the cargo interests have repeatedly been put behind Heathrow, DOT's interest in doing another deal, and so forth. I mean, it's very important to the United States. As I mentioned in my opening remarks, we provide, alone, half of the cargo airlift for the Civil Reserve Air Fleet. But our interests are always sort of over here, and Heathrow and these alliances and all are over on the other side.

So, we strongly support anything that will move European Open Skies, and do not think that all of these hypotheticals are real risks. And I, by the way, have served on six New York Stock Ex-

change boards. I know very well how boards are selected. And I can tell you, I have never seen a board of directors that can exercise their fiduciary duty to the shareholders, of making money, and accede to some noneconomic interest of a 25-percent shareholder. That's ridiculous.

Mr. SMISEK. Mr. Chairman, could I add to that?

Senator BURNS. Yes.

Mr. SMISEK. Fred has been—as he's admitted—been very eloquent on both sides of this issue. But your question about, Would we be concerned about a foreign government investing in a U.S. airline and controlling it? We would, for a number of reasons, not the least of which would be, that would—they can just turn on the tap in the treasury. That would be grossly unfair competition against U.S. airlines, because we have to go out and compete for—compete every day in the market. We have to go out and compete for capital. A foreign government owning a U.S. airline would have an—infinite resources, because all they—they can print the money on the other end. So, we'd be quite concerned about that.

Mr. SMITH. We have that situation, Mr. Chairman. We do compete with the Government of Germany. They own 60 percent of one of our two largest competitors. Every day, we compete with them. And the fact that they have unlimited funds doesn't necessarily mean they're going to be successful in the marketplace. But there's nothing in this NPRM that says that the foreign government can do anything other than own 25 percent of the shares and participate in those blue dots that Senator Lautenberg had, but not the red dots. Any of that was prohibited under the 1940 regulation that Secretary Shane mentioned.

Mr. SMISEK. Yes, I think——

Mr. SMITH. And that's what the *quid pro quo* is with the Europeans.

Mr. SMISEK. I think Mr. Shane's previous testimony made it very clear that foreign carriers could dominate and control every commercial aspect of a U.S. airline other than safety, security, CRAF, and the organizational documents. Now, they've add—that was in the original proposal—now they've added this concept of revocability, which is completely illusory, because if truly those matters were revocable, then the foreign investor would never make the investment. JPMorgan makes that point. And if it's nonrevocable, that means basically that the foreign investor will be in total domination and control of a U.S. airline.

Senator BURNS. You bet, you're in.

Senator LOTT. Thank you very much.

I'm flabbergasted to hear—let me make sure you hear this—I'm flabbergasted to hear what you just said. I don't believe he indicated anything of that kind.

My question to you, Mr. Smith, was—I'm a little shocked at what I've been hearing from a lot of the discussion today. Is the sky falling? I mean, is this going to cause, you know, aviation to collapse? What is going on here? I cannot believe—look, I've got a huge populist streak in me, but I just—I find it unfathomable that, if you might have 25 percent investment from foreign interests, that you're going to control a company. Where did that come from? Am I missing something here?

Mr. SMITH. Well, as I said a moment ago, Senator Lott, in my experience on six major New York Stock Exchange boards, I have never seen a case where 25 percent can outvote the 75 percent if the majority directors are acting as fiduciaries in pursuing the shareowners' best interests. Now, if there are *de facto* agreements on the side, which is exactly the situation that we felt was the case when DHL was permitted to *de facto* on a U.S. air carrier, that's a different matter. And, to some degree, the DOT is being accused of doing something that they're actually trying to protect against. And that was the point about Senator Lautenberg's chart. It wasn't that—the red dots are the important things, that they cannot be involved in that, and they can only be involved in the blue dots, to the extent that the 75 percent of the shares and the board of directors wants to permit them to do that.

Senator LOTT. Let me flip the question on you, then. Tell me why, succinctly, this is—it's in the best interest that we do this.

Mr. SMITH. Well, it's in the best interest for us to do it, Senator, because the history of American aviation shows that as markets liberalize around the world, American aviation interests prosper. And I think you had Mr. Whitaker give a very good case of that. If Bermuda II had not been in place, and American aviation interests had not seen our beyond rights negotiated away in 1978 under Bermuda II, you would have seen perhaps Continental, Northwest, United setting up a hub in Luten or Stanstead. Couldn't have done it in Heathrow, no question. But you—then you would have had a competing hub and a diversification of interests.

Now, if you think that's farfetched, just go read the case history of FedEx. We have a hub in Paris. We fly beyond, everyplace we're permitted. We're not permitted to fly into the U.K. We actually withdrew from Heathrow. We have a hub in the Philippines.

Senator LOTT. But under this NPRM, you would be able to do that, then, right?

Mr. SMITH. Well, if this NPRM passes, and the United States and the EU put an Open Skies Agreement, FedEx would be able to add significant additional operations from European points to Asian points and connect to other parts of our network, with substantial increase in employment of our pilots and inuring to the best interests of our shareholders.

Senator LOTT. Well, that was going to be my next question. I'm under the impression that this agreement would lead to significant impact in future agreements in China and Asia, which is where there's going to be a huge movement——

Mr. SMITH. Well, and that's the case, Senator, because this thing transcends and is much greater than just the EU agreement. If the United States demonstrates that we're unable to make this tiny step forward to further liberalize our agreement in Europe, I can assure you, there are protectionist forces in China and Asia and India and elsewhere that would use that as a signal to keep those aviation markets restricted. And we're on the cusp, I believe, in China, at least in all-cargo, of getting an Open Skies Agreement.

Senator LOTT. Captain—well, first of all, thanks to all of you for being here—Captain, it's good to see you again.

Mr. WOERTH. Thank you, sir.

Senator LOTT. I always enjoy hearing from you, and meeting with you, and hearing your testimony. In this case, it looks to me like this agreement could lead to more cargo being moved, more pilots being needed. So, why wouldn't you be for it? I mean, you— because it would be more opportunities for more pilots.

Mr. WOERTH. We are for the Open Skies. We advocate Open Skies. We do believe we participate fairly in Open Skies when we have our carriers under U.S. control. Even if the Europeans or somebody may get more, we gain some that I'm not going to hold back just so somebody might gain more than me.

Senator what I'm afraid of—we probably watched Air France— well, we're—the French community has a different social contract with its citizens, apparently, with all the riots——

Senator LOTT. Sure.

Mr. WOERTH.—that we witnessed on television. I'm worried, if Air France, which has a government stake in the airline, and KLM, which has a golden share, but it's under one bottom line—I'm worried, if they buy Delta or Northwest now, at fire-sale prices, that we start getting replaced across the North Atlantic. I mean, even if it was just a redundancy and we had a recession and wanted to lay off somebody, it's not going to be financially feasible to lay off a French person, let alone politically. It's four times more expensive. They're unemployment laws and their laws just don't prohibit it. So, a board—a fiduciary board acting in a fiduciary sense of the U.S. shareholders, would say, "We're laying off Americans. We can't afford to lay off the French, and we can't afford to lay off the Dutch or the Germans." So, I think—to the question from the Chairman, as well, I think they're kind of related here.

My concerns are that a lot of these airline interests around the world, whether it be Deutsche Post into DHL, which I know that Mr. Smith is worried about, but all the foreign airlines, they're still kind of a government entity in this regard. They're seen as an instrument of foreign policy and national pride. They're not just consumer items, like we have in this country. And I think if the Senate would take up S. 6135 and, you know, get all these issues on the table and see what we can do, I'm interested in more foreign investment, and I'm certainly interested in more opportunity. I just think this particular process, Senator Lott, falls a little short of what American workers would probably want out of this deal.

Senator LOTT. Well, that's why we have hearings like this, is to make sure we've thought through all the angles and hear differing points of view. I certainly don't want us to have to fly with French pilots. What a horrible thought that is.

[Laughter.]

Senator LOTT. But I still don't see how this level of investment is going to lead to French pilots. So, I just—I want to talk with you further about it. You know, I'm disposed to be supportive of this agreement and what we're—the Administration is trying to do. But I do appreciate your different points of view.

Thank you, Mr. Chairman.

Senator BURNS. Thank you, Senator Lott.

I've got about two or three—I'm really running up against the fire here a little bit, and I've got about two or three more questions. I'm going to address those questions to you and let you respond.

Thank you very much for your testimony here today. And as we move forward, I can't—personally right now, I can't see where 25 percent of a company you're going to be able to dictate the domestic policy that we have in this country, or our laws. We—I'm leaning that way, too. But I think there has to be some questions, and we haven't answered enough of those concerns right now to really make a decision right now.

So, I thank you for your testimony today, and I appreciate you coming today. You've opened up some areas where I had questions, and I think you've kind of laid those questions aside.

So, thank you for coming. And any other comments that you would like to make at this time with regard to this, we'll be in negotiations or in conversation with my friend from Hawaii and the rest on this committee before we do a final thing on the supplemental.

Thank you. This hearing is adjourned.

[Whereupon, at 4:10 p.m., the hearing was adjourned.]

A P P E N D I X

PREPARED STATEMENT OF HON. JOHN ENSIGN, U.S. SENATOR FROM NEVADA

Thank you Mr. Chairman. The deregulation and liberalization of the aviation industry has proven to be successful at lowering the cost of air travel, improving the quality of service, and increasing the number of travel options available to consumers. In an increasingly global world, it is Congress' duty to ensure that the laws that govern aviation are keeping pace with the ever-changing realities of the aviation industry. I look forward to reviewing the testimony of the esteemed witnesses that the Chairman has arranged for today's hearing.

The Department of Transportation (DOT) has issued a Notice of Proposed Rulemaking and a Supplemental Notice of Proposed Rulemaking that seek to clarify the rules regarding foreign investment in U.S. air carriers. Some of these rules date back to 1938 when both aviation and the world looked very different. The DOT's proposed Rule does not change the law, a power which lies solely with Congress. Rather, the proposed Rule seeks to only change the manner in which the existing law is exercised. It is wholly appropriate that the DOT now undertakes a review of how it interprets current statutes regarding foreign investment.

Increasing domestic air carriers' access to foreign investment is a worthy goal that I support. With many of our U.S. air carriers struggling financially, it is in the best interests of the country that they have as much flexibility as possible to attract capital investment. In addition, liberalizing the criteria that determine whether an air carrier is a U.S. citizen could pave the way for the signing of a U.S.-European Union Open Skies agreement. Such a free-market agreement would benefit American air travelers through increased competition while opening up vast new markets for U.S. airlines in which to compete.

However, the security and safety of the United States must be the foremost consideration in any attempt to reinterpret the foreign investment rules. Because of security concerns in a post-9/11 world, the importance of protecting the Civil Reserve Air Fleet program, and the indispensable nature of aviation in our Nation's economy, U.S. airlines must remain under the control of U.S. citizens.

As aviation enters its second century, the United States must work toward modernizing its aviation laws and regulations so they accurately reflect that the world has become a global marketplace. As the Congress and this Subcommittee prepare to take up FAA reauthorization next year, today's hearing is an important part of this ongoing effort. Thank you.

PREPARED STATEMENT OF EARL B. BOYANTON, JR., ASSISTANT DEPUTY UNDER SECRETARY OF DEFENSE (TRANSPORTATION POLICY)

PROPOSED CHANGES TO DEPARTMENT OF TRANSPORTATION EVALUATION OF U.S. AIR CARRIER ACTUAL CONTROL BY U.S. CITIZENS DURING INITIAL AND CONTINUING FITNESS REVIEWS

Chairman Burns, Senator Rockefeller, and other distinguished members of the Committee:

Thank you for the opportunity to provide information relative to the Department of Transportation (DOT) proposed rulemaking to clarify policies that DOT may use to evaluate air carriers' citizenship during initial and continuing fitness reviews. As the Assistant Deputy Under Secretary of Defense for Transportation Policy, I am responsible, in part, for developing policy supporting the Civil Reserve Air Fleet (CRAF) program. The U.S. Transportation Command (USTRANSCOM) and its Air Force component Air Mobility Command (AMC), are charged with implementing and executing CRAF policy. As requested by the Subcommittee's staff, this testimony addresses four points: (1) Department of Defense (DOD) coordination with DOT regarding the proposed rulemaking; (2) CRAF information; (3) DOD's thoughts on the impact to CRAF of a new rule; and (4) DOD concerns about a new rule.

DOD Coordination With DOT

DOT has actively coordinated with and provided information to DOD relative to the Notice of Proposed Rule Making (NPRM) and, subsequently, the Supplemental NPRM. In September 2005, DOT initiated discussions with DOD prior to issuing the NPRM. Since that time DOT has continuously kept DOD informed through meetings, telephone and video conferences, and e-mail. Likewise, the Office of the Secretary of Defense, of which my office is a part, and the USTRANSCOM staff have communicated with the DOT staff about the proposed rule.

Civil Reserve Air Fleet (CRAF) Program

CRAF History and Background

Instituted in 1952, CRAF is a voluntary, contractual arrangement between DOD and U.S.-owned air carriers to transport passengers and cargo in both peacetime and crisis. Air carriers contractually commit to provide aircraft and crews to augment DOD airlift during contingencies/emergencies when requirements exceed the capability of organic military aircraft. In exchange for that commitment, both as an incentive for participating and as compensation for the business risk that DOD might execute its contractual claim on the airline, DOD offers CRAF member carriers peacetime airlift business proportional to their respective contributions to the CRAF. The Fly CRAF Act (Title 49, United States Code, Section 41106) requires that DOD contracts for airlift be awarded to CRAF carriers, if available, in order to support CRAF participants.

Other than our commitment to offer peacetime airlift business proportionate to a carrier's commitment to the CRAF, no extra incentives or subsidies have been provided in the 50-plus years of CRAF's existence. However, DOD submitted enabling language, currently embodied in Section 802 of the draft conference report of the Fiscal Year 2007 National Defense Authorization Act bill, to provide DOD with legislative authority to contractually commit to an annual amount of business with CRAF carriers and to pay the commitment even if business does not materialize. This requirement recognizes that, in the late 1990s and 2000–2001 prior to hostilities, DOD peacetime sustainment movement of passengers and cargo diminished to the point that our business available to CRAF carriers dropped substantially. When the current operations tempo associated with Operation Iraqi Freedom and Operation Enduring Freedom diminishes, and planned realignments of U.S. forces based overseas is complete, we expect again that DOD peacetime international traffic will diminish significantly. A guaranteed line of business is the only incentive that will assure that air carriers maintain types and quantities of aircraft needed to augment DOD in the event of crisis.

CRAF provides over 90 percent of DOD's troop movement capacity and over 35 percent of cargo capacity. This longstanding government-private-sector partnership significantly enhances the United States' ability to undertake unilateral action without having to rely on foreign sources for airlift capacity or to ask the American taxpayer to fund additional quantities of air transport aircraft to be owned and operated by DOD.

CRAF Capability and Participants

CRAF is structured in three levels of effort, or *stages*:

- Stage I is the smallest and is designed to support a minor regional crisis.
- Stage II is designed to meet the needs of a major theater war.
- Stage III is designed to meet the needs of full national mobilization.

In addition to these stages, CRAF is composed of three *segments* representing specialized roles. Each segment reflects the range and authorized areas of operation for the aircraft in the segment:

- International Segment: Long- and short-range passenger and cargo capability. A significant number of aircraft in CRAF today are in the short-range international segment (less than 1,500 nautical miles).
- Aeromedical Evacuation Segment: Specialized medical airlift capability. When aircraft committed to this segment are used, the seats are removed and specialized aeromedical kits, litters, and other equipment are installed.
- National Segment: Domestic and Alaskan passenger and cargo capability. (Hawaii is in the International Segment).

If one compares the number of aircraft committed to the CRAF program in the three stages and the various segments to a typical 16-aircraft Air Mobility Command (AMC) Airlift Squadron, it is clear that CRAF can rapidly "super size" AMC's airlift capability (the following equivalents are cumulative):

- CRAF Stage I adds over 6 Squadron equivalents.
- CRAF Stage II adds over 16 Squadron equivalents.
- CRAF Stage III adds nearly 54 Squadron equivalents.

Depending on the CRAF stage and segment, civil carriers participating in CRAF must provide aircraft and crews within 24 or 48 hours of notification. At CRAF activation (discussed below), all CRAF crews are provided security clearances by AMC. For this reason, all crews must be U.S. citizens and airlines must ensure background checks are completed. The airline pilots and other crew members committed to operate CRAF flights for DOD are over and above any airline employees who are subject to call-up as members of the National Guard or Reserves.

Since inception of CRAF, the member air carriers have participated in every military contingency involving the United States, either as volunteers or under CRAF activation. CRAF provides immediate access to airlift assets valued at over $45 billion with trained U.S. crews and maintenance capabilities without extra cost to American taxpayers. In 1996, the Government Accountability Office calculated savings to the U.S. of $50 billion to $90 billion over the life of the CRAF program when compared to the cost of having the same capability in DOD's fleet of military aircraft. An update to 2006 would, in our estimation, show a savings range from $60 billion to $120 billion.

CRAF Activation Authority

Throughout the half-century of CRAF existence, the member air carriers have staunchly supported DOD requirements, most of which have been met through the carriers' voluntary participation. For example, the full duration of the Vietnam conflict was supported in this manner. However, if DOD's requirements exceed the carriers' voluntary offers, we can invoke the airlines' contractual CRAF commitment. This step is called *activation*, and is executed in the previously-described *stages* and *segments.* (For example, Stage I long-range international passenger capability might be activated.)

The Commander, USTRANSCOM, with Secretary of Defense approval, is the CRAF activation authority. When activated, in accordance with Title I of the Defense Product Act (DPA) (50 U.S.C. App 2071) CRAF carriers must give priority to DOD orders for service. In return, the DPA protects carriers from breach-of-contract lawsuits for abandoning their peacetime commercial contracts to respond to DOD CRAF activation.

The CRAF was activated (Stage II long-range international passenger and cargo) for the first time in its history to support Operations Desert Shield and Desert Storm in 1991. Over 5,500 airlift missions (20 percent of the total) were flown by U.S. CRAF member carriers, who were paid $1.35 billion by DOD for this service during activation and voluntary periods. In this instance, CRAF carriers transported to the Gulf 62 percent of the passengers moved and 27 percent of air cargo, and redeployed to the U.S. 84 percent of passengers and 40 percent of air cargo.

CRAF was activated for the second time (Stage I long-range international passenger) in 2003 in support of Operation Iraqi Freedom deployment: 399,212 passengers (93 percent of total). During the same period a total of 9,004 tons of cargo were transported by CRAF volunteers. Each of the activations were limited in duration, with subsequent support provided on a voluntary basis by the industry.

DOD's Thoughts on the Impact of a New Rule on CRAF; DOD Concerns About a New Rule

The viability of the CRAF program is extremely important to DOD. Any change to U.S. control of U.S. airlines must address its effect on our partnership with CRAF carriers. The ultimate authority of USTRANSCOM to effectively activate parts or all of the CRAF fleet must not be compromised. DOD has had a number of productive meetings and phone conversations with DOT in order to better understand the rule, and its prospective application in practice, to assess whether there is a potential impact to the CRAF program. We would expect to have concerns if impacts are identified and not mitigated or if, after assessment, uncertainty remains. However, at this time we have not reached a conclusion on impacts.

Based on our ongoing consultations, it is clear that DOT intends for the proposed rule to ensure the availability of commercial aircraft for national defense purposes, including CRAF commitments. We will continue to work with DOT to ensure that the rule achieves this end, and will advise the Subcommittee of our conclusions.

Conclusion

The CRAF program relies heavily on voluntary participation from civil air carriers. Civil airlift is a more critical element than ever before in support of the National Defense Strategy. Except for the requisitioning of ocean vessels, no authority

exists to nationalize or seize any transportation asset, even when war has been declared. Having mentioned ocean vessels, it should be noted that approximately half of the Maritime Security Fleet (MSF) vessel companies are ultimately owned by foreign interests. Nevertheless, they meet the MSF statutory requirements to participate in the Voluntary Intermodal Sealift Agreement (VISA), which is the sealift equivalent to CRAF as a national emergency mobilization program. These ocean carriers have thoroughly proven their willingness and ability, notwithstanding ownership, to quite satisfactorily support Operations Iraqi Freedom and Enduring Freedom.

The decreasing numbers of military airlifters has resulted in a greater reliance on civil aircraft to meet airlift requirements in peacetime and contingency situations. Volunteer programs such as CRAF are essential to meet our national defense needs. CRAF embodies a significant capability to support the Combatant Commanders and the Soldiers, Sailors, Airmen, Marines, and Coast Guardsmen who execute the orders of the Commander-in-Chief.

In closing Mr. Chairman, thank you for the opportunity to provide this written testimony before the Committee about DOT's proposal to clarify policies that DOT may use to evaluate air carrier actual control by U.S. citizens during initial and continuing fitness reviews and the potential impact on CRAF.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. TED STEVENS TO HON. JEFFREY N. SHANE

Question 1. Under Secretary Shane—It's been documented that the U.S. and EU Open Skies Agreement may hang in the balance of Congress' decision on your rulemaking. What does that Open Skies agreement mean to the American consumer and traveler?

Answer. The Agreement will enable U.S. consumers to obtain lower fares and a greater variety of airline services in transatlantic markets. The Agreement could have a profound impact in reshaping the route maps for transatlantic aviation. Business travelers, tourists and shippers will be able to choose from the whole panoply of U.S. and European airlines, because the Agreement will authorize every EU and every U.S. airline:

- to fly between every city in the EU and every city in the United States, including opening up operations between the United States and the United Kingdom;
- to operate without restrictions on routes or capacity, including unlimited rights to fly beyond the EU and U.S. to points in third countries;
- to set fares freely in accordance with market demand; and
- to enter into cooperative arrangements with other airlines, including code-sharing and leasing.

This Agreement has the potential to dramatically increase the quality of competition in the market and benefit consumers and communities on both sides of the Atlantic, in ways that transcend anything achieved through our existing open-skies accords.

Completion of the U.S.-EU Agreement would not only enhance the quality of airline competition across the Atlantic, it would set a new standard for liberalization around the world. By enhancing the competitiveness of U.S. airlines, the Agreement would create a center of gravity and a tool that could loosen the grip of protectionism in other markets.

Question 2. Under Secretary Shane—The Department of Defense CRAF program relies on appropriate fleet composition. CRAF needs large international-range aircraft. Some opponents of your rule have suggested a foreign entity could essentially move all wide-body large aircraft to their overseas routes, leaving only small non-CRAF usable aircraft in the U.S. Should Congress be concerned about unintended impacts on the CRAF program fleet?

Answer. No. Congress should not be concerned about unintended impacts on the CRAF program fleet as a consequence of our proposed rule. The Department strongly believes that our proposed rule will not have any negative effect on DOD programs. Because our proposed rule requires that U.S. citizens control all decision-making involving CRAF and other national defense programs, the air carrier could not allow foreign investors to make decisions that would make participation in CRAF or other national defense airlift operations impossible as a practical matter.

Were a U.S. airline to decide to withdraw its participation in the CRAF program or to sell off its fleet of intercontinental aircraft, or to implement any other decision damaging to our national defense airlift needs, we would expect the Department of

Defense to advise us of the situation and its impact on its programs, just as we would expect to hear about safety or security problems from FAA or TSA. In such circumstances, the Department would undertake an immediate investigation to determine whether the air carrier was conforming to its obligations under our proposed rule to ensure that U.S. citizens wholly controlled decisions relating to DOD programs. Importantly, a failure to comply with that obligation would call into question the air carrier's eligibility to retain its operating certificate. Therefore, airline management can be expected to take those obligations very seriously.

Question 3. Under Secretary Shane—During the last FAA reauthorization debate, Congress essentially codified the citizenship standards to include "actual control." Under what authority do you believe these requirements can be changed by DOT and not Congress?

Answer. The Department has not proposed to change (and could not change) the requirement that U.S. citizens must actually control each U.S. carrier. The Department will continue to ensure that U.S. citizens actually control each U.S. carrier.

The statute, however, does not define "actual control," and the Department never established a fixed definition of "actual control" before or after Congress added the requirement to the statute. Because Congress gave the Department the responsibility for enforcing the requirement, the Department necessarily has some discretion to define "actual control" and to modify that interpretation when changing industry circumstances make doing so appropriate. In fact, the Department over the years has changed its interpretation of "actual control."

The Department's SNPRM contains a detailed discussion of the Department's tentative conclusions on its authority to modify its interpretation of "actual control." 71 Fed. Reg. at 26436–26438. The parties may address this issue in their comments on the SNPRM, and the Department will carefully consider those comments in making its final decision on whether it may or should adopt its proposal.

Question 4. Under Secretary Shane—Can you discuss the situation regarding Heathrow Airport in London? Some of the challenges to the Open Skies agreement revolve around access to Heathrow. If an Open Skies agreement and the rulemaking went forward, do you anticipate domestic winners and losers in gaining access to Heathrow, and why wasn't Heathrow access part of the Open Skies discussion?

Answer. The current agreement between the United States and United Kingdom allows only two U.S. and two U.K. airlines to serve Heathrow. The Open-Skies agreement will give every U.S. air carrier the opportunity to serve that airport, subject to the availability of slots.

There is a well-established market for slots at Heathrow. The U.K. courts have upheld the longtime practice of trading slots with additional compensation going from one airline to the other. Thus, contrary to assertions by some, slots are traded actively and can be obtained at Heathrow. They may not be immediately available at the very best times, and they will not be free. But U.S., British, and third-country carriers have for years traded and, in effect, purchased slots at the airport. I cannot predict the results for individual U.S. carriers that would be newly eligible to serve Heathrow under a U.S.-EU agreement. However, I am certain that the longer we wait to make all of our carriers eligible to fly to Heathrow, the harder it will be for them to get acceptable slots as congestion continues to grow.

During the negotiations, the concerns of some U.S. carriers about slot limitations at European airports, in particular Heathrow, were raised. The U.S. negotiators sought and obtained language in the agreement that allows us to address slot and other infrastructure problems in the Joint Committee. The U.S. side did not, however, pursue special infrastructure advantages solely for American carriers, such as designated slots, gates, and counters at London's Heathrow Airport. Such a provision would be inconsistent with EU slot regulations and with established non-discriminatory international norms for slot allocation—norms that we insist on for U.S. carriers with other countries.

Question 5. Under Secretary Shane—If Congress eliminated the language currently in the Supplemental Appropriations bill and allowed the rulemaking to move forward, what is the timeline on a new rule, and when do you expect the European Commission to decide on the Open Skies agreement?

Answer. Comments on the Supplemental Notice of Proposed Rulemaking are due on July 5. The Department intends to consider carefully the comments received. If, following our review, we decide to finalize the rule, we hope to do so in time for the European Commission and its 25 Member States to decide on the proposed U.S.-EU Air Transport Agreement at the October 12 EU Transport Council meeting.

Question 6. Under Secretary Shane—Opponents have stated foreign investors could essentially gain "super majority" control over U.S. airlines through your rule-

making. Could you describe what is meant by "super majority" and how the rulemaking would address that scenario?

Answer. A "super-majority" voting clause in a corporation's articles of incorporation (or charter) or by-laws requires specified types of decisions to be approved by more than a bare majority of the directors or shareholders (a clause might, for example, require approval by two-thirds of the directors or voting shares). Minority investors in U.S. corporations often obtain super-majority clauses of this kind in order to protect their legitimate interests as investors. A super-majority clause does not give the investor any ability affirmatively to require a corporation to take any action.

The Department stated that its proposal could allow qualified foreign investors to hold some super-majority rights essential to protect their interests, but that the Department could not now define which kinds of super-majority voting clauses it would permit under the actual control requirement. The Department tentatively concluded that the appropriateness of any specific super-majority voting requirement would depend on the precise nature of the clause and the nature of the foreign investors' involvement in the carrier. If the proposal is finalized, foreign investors could not use super-majority voting rights to control a carrier's organizational documents, safety and security matters, or its participation in national defense airlift operations, including CRAF, because those matters would remain under the present regulatory regime in which no substantial foreign influence is permitted. The SNPRM gives the parties in the rulemaking the opportunity to comment on this issue, and the Department expects to receive a number of comments on super-majority voting clauses.

Question 7. How many European air carriers are state-owned or partially state-owned?

Answer. Although the Department does not systematically monitor ownership of foreign airlines, in an effort to be responsive, we undertook a limited ownership review of European air carriers using various public data-sources that were available to the Department. We sampled 31 foreign air carriers whose homelands are members of the European Union (we sampled all European Union countries) and who now provide U.S.-Europe scheduled combination air service (persons, property, and mail), all-cargo service, and charter services. Our evaluation of this category of companies indicated that five air carriers are wholly owned by their governments (three are from Eastern European countries), and seven air carriers are partially state-owned. Importantly, while the Department does not maintain current ownership information on foreign airlines, we note that all prospective foreign investors in a U.S. air carrier wanting to take advantage of our liberalized control policies would be required to fully satisfy the Department that the requisite reciprocity of investment opportunity exists.

Question 8. Under Secretary Shane—Under the rulemaking, the investment situation with another country must be reciprocal. What do you envision would happen if a U.S. carrier wanted to invest in a foreign, state-owned or partially state-owned airline?

Answer. If a foreign country effectively bars U.S. citizens reciprocal investment and commercial decision-making opportunities in that country's airlines because those airlines must remain wholly state-owned, reciprocity would be lacking and, unless otherwise required under U.S. international obligations, investors from that country would not be able to take advantage of our proposed rule, if we make it final. With respect to partially state-owned airlines, we are not aware of any reason that the reciprocity requirement could not be met, as long as U.S. citizens could invest in the same amount of voting stock as allowed under U.S. law and have the same commercial decision-making opportunities as we are proposing for foreign citizens.

Question 9. Under Secretary Shane—Would this rulemaking lead the European States to invest in their airlines in order to block U.S. investment?

Answer. One trend in Europe, reinforced by aggressive European Commission action against state aid, has been a decline in state-ownership interests, and another has been a rise in both multinational European airlines and privately-owned low-fare carriers. We expect those trends, based on their own commercial imperatives, to continue. Moreover, the Europeans recognize that an important element of our rulemaking proposal is the reciprocity condition. If reciprocity cannot be established, investment opportunities in the United States will not be available.

Question 10. Under Secretary Shane—Since no U.S. airlines are state-owned, would there be disproportionate opportunities available to European investors versus U.S. carriers?

Answer. No. Under current U.S. law, qualified foreign investors can hold up to 25 percent of the voting stock of a U.S. airline. Our proposed rule does not alter that foreign investment limit. If made final, however, our proposal would permit foreign investors to take advantage of our more liberal commercial decision-making opportunity standards, only if the foreign investors come from countries that have signed an open-skies agreement with the U.S. and provide to U.S. investors reciprocal investment opportunities in their airlines.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. DANIEL K. INOUYE TO HON. JEFFREY N. SHANE

Question 1. Under your proposal, you allow a foreign investor to control key economic decisions of a U.S. air carrier. The foreign investor, for example, would have the authority to change the fleet mix of that airline's domestic operations, including reducing aircraft that are used by the Department of Defense (DOD) in a crisis, under the Civil Reserve Fleet Program (CRAF). What role will the DOD have in reviewing a decision by a foreign entity to sell off key assets?

Answer. The Department strongly believes that our proposed rule will not have any negative effect on DOD programs. First, we would expect each air carrier to continue to make its fleet decisions based on its perceptions of the fleet mix best suited to a successful commercial operation. The Department expects that foreign investor interests will be the same as U.S. investors', when permitted by the airline's U.S. citizen majority owners to affect fleet decisions. Additionally, to remain compliant with our proposal, the U.S. citizen owners would have to retain the right to revoke any delegation of decision-making to the foreign investors.

Were a U.S. airline to decide to withdraw its participation in the CRAF program or to sell off its intercontinental aircraft, or to implement any other decision damaging to our national defense airlift needs, we would expect the Department of Defense to advise us of the situation and its impact on its programs, just as we would expect to hear about safety or security problems from FAA or TSA. In such circumstances, the Department would undertake an immediate investigation to determine if foreign investors had made or unduly influenced the U.S. air carrier's ability to contribute to DOD programs and whether the air carrier was conforming to its obligations under our proposed rule to ensure that U.S. citizens wholly controlled decisions relating to DOD programs. Importantly, a failure to comply with that obligation would call into question the air carrier's eligibility to retain its operating certificate. Therefore, airline management can be expected to take those obligations very seriously.

Question 2. As the Department of Defense (DOD) notes, the Civil Reserve Air Fleet (CRAF) program relies heavily on voluntary participation, and with the exception of requisitioning ocean vessels, no authority exists to nationalize or seize any transportation asset, even when war has been declared. The DOD has not reached a conclusion on the impact of your proposal, but believes they would expect to have concerns if uncertainty remains following their assessment. Why are you certain that the CRAF will not be affected by the Supplemental Notice of Proposed Rule Making (SNPRM) prior to implementation of a final rule when the DOD is not similarly convinced?

Answer. The CRAF program is a voluntary, *quid pro quo* arrangement by which airlines agree to commit aircraft for military airlift, and in return, gain access to U.S. Government business. Because each carrier's participation in CRAF and other national defense airlift operations is voluntary, the Department crafted its proposed rule to ensure that U.S. citizens control each U.S. air carrier's decision on whether to participate in the program. In formulating this position of protecting the CRAF program, we consulted with DOD and we will continue to work with the officials at the Department of Defense toward this objective.

As our proposed rule states, its provisions would not permit foreign investors to control U.S. air carrier decisions on CRAF or other national defense airlift participation, even if the foreign investors became more involved in other areas of the air carrier's operations. The Department would require such decisions to be clearly and demonstrably subject to actual control by U.S. citizens. This would mean that the air carrier could not allow foreign investors to make decisions that would make participation in CRAF or other national defense airlift operations impossible as a practical matter. As the DOD notes, participation in CRAF has been and will continue to be voluntary, therefore, just as today, each air carrier will continue to choose whether it will participate in CRAF or other national defense airlift operations. We do not believe that anything in our proposed rule would negatively affect such a choice.

Question 3. When is the DOD assessment of your proposal expected to be completed?

Answer. The Department of Defense has already indicated that it does not object to the adoption of a rule along the lines currently proposed. DOD and DOT are working together to establish new inter-departmental procedures ensuring that DOD concerns regarding CRAF carriers are fully addressed. Similarly, the Department of Homeland Security, after reviewing the proposal with great care, has indicated that they also do not object to our adoption of the proposed rule.

Question 4. The Committee on Foreign Investment in the United States (CFIUS) reviews are necessitated when a foreign entity acquires control through an acquisition, merger, or takeover of a U.S. company. Will the expanded foreign investment into U.S. air carriers, allowed for by the Department of Transportation's (DOT) Supplemental Notice of Proposed Rule Making (SNPRM), require a CFIUS review?

Answer. No. CFIUS applies only to acquisitions, mergers, and takeovers, none of which would be permitted under this rule. Whether or not the proposal is finalized, foreign investors' stock ownership is now and would continue to be limited by the statute to no more than 25 percent of the voting stock of an air carrier. A CFIUS review would not be required or necessary because the air carrier would remain majority-owned and controlled by U.S. citizens.

Question 4a. If so, why would that be necessary if the DOT is confident that "actual control" of domestic air carriers will remain in the hand of U.S. citizens?

Answer. As stated in the previous question, we do not believe that implementation of our proposed rule would require a CFIUS review.

Question 5. You have long supported a change in U.S. foreign investment laws in domestic air carriers. Why did the Department of Transportation (DOT) not come to the Congress to ask for a change in the law, so that a deal with the European Union (EU) could be negotiated?

Answer. The Department has not sought legislation for its proposed modification of its past interpretation of the actual control requirement, because the Department believed that no legislation was necessary. The Department is proposing only to modify its own interpretation of "actual control," not to modify any requirement imposed by Congress. Because Congress did not enact a definition of "actual control," the past interpretations of "actual control" were created by Department decisions in initial certification proceedings and continuing fitness reviews. The Department will continue to enforce all of the statutory citizenship requirements for U.S. carriers, including the requirement that U.S. citizens must actually control each U.S. carrier.

Additionally, I wish to emphasize that this rulemaking has been initiated and pursued based on its own merits and not for purposes of achieving any agreement with the European Union.

Question 6. Did you believe that allowing greater foreign investment by increasing the 25 percent threshold to 33 percent or even 49 percent would not be sufficient to spur investment? So, without changing even the percentage threshold, how does your proposal equate to greater foreign investment?

Answer. Foreign citizens would be more likely to make investments in a U.S. carrier if they could obtain some ability to protect their investment and influence the carrier's use of the funds provided by them, even if they may not own more than 25 percent of the shareholders' voting interest. Minority investors in any U.S. company typically wish to obtain some protection for their investment, such as agreements requiring their consent before the company may implement certain types of major corporate transactions, and some ability to influence the company's use of their investment. The Department's traditional implementation of the actual control requirement barred foreign investors in U.S. carriers from obtaining either such protection or any significant ability to participate in managing the carrier's use of their investment. The Department's proposed policy, if adopted, would allow foreign investors to obtain some protection for their interests and some ability to influence the carrier's operations. As a result, it would encourage foreign citizens, especially strategic investors, to make minority investments in U.S. carriers that they would not be willing to make under the current interpretations.

Question 7. If the Department of Transportation (DOT) does complete a final rule based on the SNPRM, will it guarantee ratification of an Open Skies agreement with the EU?

Answer. I cannot guarantee what the European Commission and its 25 Member States will do. All indications are that the Europeans are satisfied with the proposed Agreement reached in November. Therefore, I am optimistic that it can be approved. However, I am convinced that the Agreement will not move forward without DOT's issuing a final rule.

Question 8. Under your proposal, could Air France merge with a U.S. carrier, assuming it already has antitrust immunity for its dealings with a carrier?

Answer. As a practical matter, I believe that Air France would never merge with a U.S. carrier due to the requirements imposed by existing Federal statutes even if the Department adopts its proposed modified interpretation of "actual control." The statute states that a carrier cannot be a U.S. air carrier unless U.S. citizens hold at least 75 percent of the shareholders' voting interest and the carrier is a corporation organized under the laws of the United States, one of the states, the District of Columbia, or a territory or possession of the United States. As a result, a merger between Air France and any U.S. air carrier would only be possible under U.S. law if the surviving corporation were the U.S. carrier and the foreign investors were willing to hold no more than 25 percent of the voting interest in that corporation. If Air France acquired a U.S. carrier without complying with these requirements, the U.S. air carrier would lose its operating authority as a U.S. carrier. On the other hand, if the surviving corporation were a U.S. carrier, it presumably would not be deemed a French carrier by the United States or foreign governments under applicable air services agreements and so would likely lose any route rights created by such agreements for the benefit of French carriers.

Question 9. Under what section of law is this type of merger permissible?

Answer. If a foreign carrier wished to merge with a U.S. carrier, the surviving carrier would be a U.S. carrier only if it continued to comply with the statutory definition of a U.S. citizen, 49 U.S.C. 40102(a)(15). The merger would also be subject to the antitrust laws enforced by the Justice Department, including the Hart-Scott-Rodino Act, which proscribe foreign acquisitions of U.S. firms only when they would be anticompetitive.

Question 10. The proposed rule indicates that you will leave control of key areas, such as safety, security, and Civil Reserve Air Fleet (CRAF), in the hands of U.S. citizens. However, the process that determines whether or not U.S. citizens maintain control will be confidential. How can the Senate judge the impact of this rule without specific details regarding enforcement or oversight?

Answer. Initial applications for air carrier certificates are docketed public proceedings. Moreover, any significant investment in a publicly-held U.S. air carrier must, by law, be disclosed in the company's SEC filings. Further, the Department has the discretion to make public continuing fitness reviews when the Department believes that it would be in the public interest to do so. For example, we recently released a letter to Hawaiian Airlines that set a useful precedent that we felt the public should be aware of so that others could take advantage of it. We have also docketed continuing fitness reviews in the past—up to and including oral evidentiary hearings before an Administrative Law Judge.

Question 11. Safety impacts almost everything an airline does. Can you be more specific about the sort of decisions reserved for U.S. citizens in the areas of safety, security, government procurement, and organizational documents?

Answer. With any air carrier, there are officials whose responsibilities involve primarily safety and security matters, such as the Directors of Safety, Operations, and Maintenance, the Chief Pilot, the Chief Inspector, the Aircraft Operator Security Coordinator, and the Ground Security Coordinator. Those officials, as well as others whose primary concerns are safety, security, and national defense airlift participation would have to report to U.S. citizens, up to and including the President and CEO of the company, who must be U.S. citizens. The carrier will have to designate the individuals responsible for these core decisions, including the officials who are charged with the decision-making duties for national security commitments, who they report to, and who sets their budgets and compensation.

As to the organizational documents, the U.S. citizens would have to set up a structure consistent with the parameters set out in the rulemaking, and the foreign minority investor would not be permitted to alter those documents or structure. These organizational documents additionally could be the means by which any delegation of authority to the foreign investor would occur, and, similarly, where provisions for revocability of that delegation would exist.

While there could be a disagreement between those officials responsibility for safety, security, or national defense commitments, and a foreign official with delegated authority to make some commercial decisions, that conflict would—as with all large organizations—rise to the levels of the senior executives or Board of Directors for resolution. As a majority of those officials and directors must, by statute, be U.S. citizens, U.S. citizens necessarily would determine the outcome of those disagreements.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. FRANK R. LAUTENBERG TO HON. JEFFREY N. SHANE

Question 1. Do you feel the Federal Government has performed adequate safety and security oversight over airline maintenance operations, including maintenance performed at foreign facilities?

Answer. Yes. Over the last several years, the Federal Aviation Administration (FAA) has changed the way it oversees aircraft maintenance. In the past, FAA's inspectors were required to complete a prescribed number of oversight activities focused on compliance with FAA regulations. In 1998, FAA began overseeing the ten largest airlines using the Air Transportation Oversight System (ATOS) model which goes beyond simply ensuring regulatory compliance. The goal of the oversight model is to foster a higher level of air carrier safety using a systematic, risk-management-based process to identify safety trends and prevent accidents. ATOS has improved safety because it identifies and helps manage risks before they cause problems by ensuring that carriers have safety standards built into their operating systems.

Oversight of repair stations is a good example of why our current focus on risk management is preferable to compliance based oversight. We know that, if some maintenance component is identified as a risk, our oversight focus would be triggered, regardless of who or where the maintenance is performed.

I am confident that the changes we have made in our oversight philosophy and the work we continue to do with input and assistance from the aviation community, Congress, and the international community has contributed to this historically safe period of commercial aviation safety. Our safety oversight must keep pace with the industry as it changes and I think we are well positioned to accept that challenge.

The FAA is currently assisting the Transportation Security Administration (TSA), DHS, in drafting a notice of proposed rulemaking to address security requirements and to conduct security audits of FAA Part 145 certificated repair stations. TSA will also use a risk management-based approach in developing assessment criteria, assessment schedules, and decisionmaking matrices to address repair station findings. A required self-assessment tool and on-site inspections will begin after the publication of a final rule. As the program matures TSA will refine its risk management process. TSA has requested and received FAA assistance in the development of repair station training materials. Additionally, the FAA has agreed to assist in delivery of repair station training.

Question 2. Do you feel the Federal Government has sufficient resources to adequately perform safety and security oversight over airline maintenance operations, including maintenance performed at foreign facilities?

Answer. Yes. Funding provided in FY 2006 has enabled FAA to address critical safety and security oversight requirements. In addition, FAA has reprogrammed some funds and has requested that Congress approve the use of funds consistent with Section 511 of last year's appropriation bill. With these additional funds, Flight Standards (AFS) will be able to hire 139 safety-critical staff in FY 2006—55 with funds already appropriated by Congress and 84 with funds from the Section 511 request and internal reprogramming. Most of this additional safety-critical staff—80 new staff—will strengthen our safety oversight of repair stations, including foreign facilities. This includes implementing the Enhanced Repair Station Oversight Program at all 5,018 repair stations.

This oversight program will:

- Establish a risk-based surveillance system to identify and target inspector resources as required.
- Enhance the surveillance process by expanding on the current facility inspection program.
- Capture data for risk mitigation.
- Establish a repair station assessment program comprised of focused inspections.
- Establish oversight programs that utilize resources more effectively for large and complex repair stations performing maintenance on air carriers (*e.g.,* certificate management teams).

The balance of 59 new staff will provide needed increases in other areas of safety oversight, including financially distressed carriers, fractional ownership, and emergency medical services.

Question 3. The Department's proposal would make any delegation of authority to foreign citizens "revocable." What evidence does the Administration rely on to show that this contract/model could work or has worked in the context of a complex entity like an airline operation?

Answer. It has been the Department's practice to prevent foreign investors in any U.S. air carrier from exerting control or undue influence over any aspect of an air carrier's operations, regardless of the amount of foreign investment made and/or percentage of equity held by the foreign interests. In most cases, U.S. air carriers include numerous provisions in their organizational documents (*i.e.,* charter agreements, bylaws, etc.) to prevent foreign control over the company and to maintain its strict adherence to the Department's U.S. citizenship requirements. In reviewing an air carrier's ownership structure in initial and continuing fitness review cases, we have found that air carriers are fully aware of the Department's scrutiny when foreign investors are involved and that these air carriers take the necessary steps to remain under the actual control of U.S. citizens. The Department's current practices have proven very effective in these matters, and we are confident that they will continue to serve the public interest well.

Question 4. Will foreign investors truly be able to control and protect their investment, if control is subject to revocation at any time? And if they don't have this control, why would they invest in the first place?

Answer. The Department's proposal would allow foreign investors to have greater involvement in the commercial decisions of the airlines in which they have invested, giving the investors some protection over their investments. As a practical matter, in most cases, the U.S. citizens in control of the airline would revoke delegated authority only in the event that the foreign investor attempts to make decisions that are contrary to the airline's best interests, therefore contrary to the interests of the majority U.S. stakeholders. For our part, the Department believes that foreign investor motivations would usually complement U.S. investor motivations in these matters. Even with the revocability provisions, the proposal is attractive to foreign investors because, again, it would allow them to participate more actively in the air carrier's commercial decisions, whereas under existing policy, foreign investor involvement is virtually nonexistent.

Question 5. Do you believe that U.S. commercial pilots should be certificated by the USDOT beyond age 60? What is the basis of your decision?

Answer. Certificating U.S. pilots in part 121 operations beyond age 60 would require rulemaking to demonstrate to the public how such a modification would maintain safety. The consistency of findings across both FAA and non-FAA studies have shown aging to be a factor in commercial piloting. The findings of these empirical studies, using various analytic methodologies, do not support a rule change.

The Air Line Pilots Association and the International Federation of Airline Pilots' Associations currently support an age 60 limit. In September 2002, we received nearly 7,000 comments in response to a petition for an exemption to the age 60 rule, the majority of which favored retaining the age 60 limit. Commenters cited safety and medical issues most often in their reasoning.

For these reasons, we are unable to justify a rule change at this time.

RESPONSE TO WRITTEN QUESTION SUBMITTED BY HON. TED STEVENS TO JEFFERY SMISEK

Question. Continental is a member of the SkyTeam alliance, along with 9 other major international airlines. Of those airlines, none have rights to serve London's Heathrow Airport from the U.S. Does Continental object to the Open Skies framework under negotiation between the U.S. and EU? Is your opposition to the rulemaking a reflection of your concerns about a new U.S.-EU agreement?

Answer. Continental is the only U.S. Member of SkyTeam that does not hold antitrust immunity with any other SkyTeam Member. Of the ten carriers in SkyTeam,* four (Air France, KLM, Alitalia, and CSA Czech) are from the EU, and each has access to (and currently serves) Heathrow and would, even under their current bilateral Open Skies Agreements with the U.S., have the right to fly between their home countries and the United States through London's Heathrow Airport. Even Korean Air lines (also a Member of SkyTeam) could fly from Korea through London's Heathrow Airport to the United States under the current U.S.-Korea Open Skies agreement. Therefore, it is not correct that "none have rights to serve London's Heathrow Airport from the U.S." Although all of the foreign SkyTeam carriers (with the exception of Aeromexico and Aeroflot) may serve the U.S. through London's Heathrow Airport, not one of the U.S. carriers in SkyTeam has that right. While the EU Open Skies agreement would technically allow the U.S. carriers to serve Heathrow Airport, it has been well documented that there are no competitive

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* SkyTeam carriers: Aeroflot, Aeromexico, Air France, Alitalia, Continental, CSA Czech, Delta, KLM, Korean Airlines, Northwest.

slots and facilities available. Therefore, Continental would not gain competitive access to Heathrow.

Continental is uniquely disadvantaged by the U.S. failure to gain slots and facilities at Heathrow, as part of the EU Open Skies Agreement. Unlike Delta and Northwest, we do not have antitrust immunity with any of the EU carriers (or any other SkyTeam carrier), so there is no reason that other SkyTeam members would consider transferring slots to Continental. While Delta and Northwest have limited service to the U.K., Continental has developed an extensive U.S.-U.K. network, serving 7 U.K. cities from the U.S. and, therefore, is currently the strongest U.S.-U.K. competitor to British Airways and Virgin Atlantic in U.K. markets where we are allowed to compete unconstrained. If the so-called EU "open skies" agreement were to be ratified, the U.K. carriers, who hold the vast majority of all slots at prime times for transatlantic service, would expand their Heathrow-U.S. services without any constraints. Without competitive access to Heathrow, Continental's entire U.K. network would inevitably be weakened, strengthening the power and market share of the U.K. carriers and their partners.

This is exactly why Continental finds it frustrating that the U.S. DOT has been willing to ignore U.S. law in order to provide European carriers immediate and unfettered access to U.S. markets, while refusing to even negotiate for a process whereby U.S. carriers could be assured of the commercially viable slots and facilities necessary for competitive access to the most important airport in the EU as soon as a U.S.-EU agreement is signed.

Additionally, we object to the rulemaking because it is blatantly unlawful and, as a result, ineffective in encouraging any new foreign investment. In fact, JPMorgan, one of the most sophisticated investment banks in the world, has recently indicated that it could not recommend foreign investment in U.S. airlines based on the Department's proposals.

RESPONSE TO WRITTEN QUESTION SUBMITTED BY HON. TED STEVENS TO MICHAEL G. WHITAKER

Question 1. United is one of the major members of the Star Alliance. Star now has 18 members. How do you expect U.S. carrier's financial health or viability to change as a result of this rulemaking?

Answer. U.S. airlines have weathered enormous financial challenges in recent years. Foreign competitors, including members of the Star Alliance, have fared much better. The current international regulatory environment contributes to our financial weaknesses by limiting markets, discouraging investment and inhibiting international expansion.

The NPRM, the pending air services agreement between the United States and the European Union, and other actions to remove outdated regulatory barriers on international aviation are very important for U.S. carriers to regain long-term financial stability. U.S. airlines need greater access to growing markets around the world, the ability to invest in operations outside the United States, and more opportunity for cooperation with our international partners. Such improvements would allow airlines to spread business risk geographically and better withstand economic peaks and valleys inherent in the airline industry.

Question 2. What sorts of daily operational decisions could be affected by foreign strategic investors in United, if possible?

Answer. The Department of Transportation's proposal regarding foreign control of U.S. airlines is intended to provide greater flexibility to U.S. carriers seeking to attract foreign investment. Our understanding is that U.S. carriers would have the option to offer foreign investors a greater degree of involvement in the commercial decision-making and management of U.S. carriers than is currently permitted by DOT case law precedent. The precise nature and degree of such involvement (within the limits prescribed by the proposal) would be established on a case-by-case basis between the U.S. carrier majority owners and the foreign investors. In general, the DOT proposal would permit the U.S. carrier majority owners and the foreign investors broad authority to allocate commercial decision-making and management responsibility between them, so long as U.S. citizens retain actual control (including control over organizational documents, safety, security and the Civil Reserve Air Fleet program) of the U.S. carrier.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. TED STEVENS TO CAPTAIN DUANE WOERTH

Question. It has been suggested that allowing increased foreign investment in U.S. airlines will better position our carriers for financial health and internal growth. Lacking additional financial opportunities exposes the industry to more hardship during the next downturn. What is ALPA's view of projected growth in the domestic industry, particularly as it applies to hiring new pilots to meet increasing demand? Would changing the limits on foreign ownership contribute to the certainty of future growth?

Answer. Per your inquiry, we would point out at the outset that DOT's proposal does not change the existing limits on foreign investments in U.S. airlines. The limit would remain at 25 percent of the voting shares. Rather, what DOT is proposing to change is the prohibition against foreign control of U.S. airlines, in the hope that this change would attract more foreign investment (up to the existing limit).

DOT has presented no hard data to show that such radical change in the foreign control rules is necessary to ensure that the U.S. airline industry has adequate access to capital investment. If some U.S. carriers are currently having difficulty finding capital, we believe it is because of the precarious financial condition of the industry rather than any regulatory restrictions on foreign investment.

In fact, there is evidence that when a U.S. airline shows some significant promise of profitability, it is able to find the capital it needs. For example, United Airlines, after engaging in extensive restructuring, cost-cutting and changes in operations and services while in Chapter 11, was able to obtain $3 billion in debt exit financing, on terms that CEO Tilton described as "good even for my old business." Similarly, US Airways, after going through its own Chapter 11 restructuring and merging with America West, obtained $1.5 billion in exit financing, of which $350 million was in the form of equity commitments. Moreover, $75 million of the equity was foreign investment provided by ACE Aviation Holdings, the parent of Air Canada. These major financings strongly indicate that both foreign and domestic capital is available to U.S. airlines if they appear to offer a reasonable return to the investor.

DOT asserted in its NPRM that the carriers currently in Chapter 11 have "struggled to find the capital necessary to enable them to exit Chapter 11 protection." 70 Fed. Reg. 67393. It is not surprising that the search for capital for an enterprise—any enterprise—that has had to seek Chapter 11 protection will be something of a "struggle." What is more significant is that two major airlines, United and US Airways, successfully found such financing once they had restructured and put together a promising business plan, despite their long histories of financial difficulty. And in the case of US Airways, such financing included a substantial contribution by a foreign investor, ACE, which will also have a seat on the airlines Board of Directors. While there are several other airlines currently in Chapter 11 that have not yet obtained exit financing, those airlines have also not yet completed their restructuring. If they are able to restructure and produce a viable business plan as United and US Airways have done, there is no reason to believe they will not also find whatever financing they require. Indeed, a Dow Jones Newswire reported in December that Northwest Airlines has already reached a new financing agreement with Airbus, pursuant to which "Airbus affiliate AVSA [will] provide or procure financing for 85 percent of an undisclosed number of Airbus A319 aircraft scheduled for delivery this year," and "for 85 percent of up to 10 A330 aircraft to be delivered in 2006 and 2007."

In short, ALPA believes that there is no need to change the foreign control rules to ensure that the airline industry has adequate access to capital investment. Rather, what is needed are measures to promote the economic health of the industry, such as relief from discriminatory and burdensome taxes.

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